

1-1-2007

# Government auditing standards and Circular A-133 audits - 2007/08; Audit risk alerts

American Institute of Certified Public Accountants

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## Recommended Citation

American Institute of Certified Public Accountants, "Government auditing standards and Circular A-133 audits - 2007/08; Audit risk alerts" (2007). *Industry Guides (AAGs), Risk Alerts, and Checklists*. 1083.  
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AUDIT RISK ALERTS

# ***Government Auditing Standards and Circular A-133 Audits — 2007/08***

*Strengthening Audit Integrity  
Safeguarding Financial Reporting*

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS



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*Strengthening Audit Integrity  
Safeguarding Financial Reporting*

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS



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1 2 3 4 5 6 7 8 9 0 AAG 0 9 8 7

ISBN 978-0-87051-695-5

## Notice to Readers

This Audit Risk Alert is intended to provide auditors who perform audits under *Government Auditing Standards* or Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, with an overview of recent industry, technical, regulatory, and professional developments that may affect the audits and other engagements they perform.

This publication is an *other auditing publication* as defined in AU section 150, *Generally Accepted Auditing Standards* (AICPA, *Professional Standards*, vol. 1). Other auditing publications have no authoritative status; however, they may help the auditor understand and apply the Statements on Auditing Standards.

If an auditor applies the auditing guidance included in an other auditing publication, he or she should be satisfied that, in his or her judgment, it is both relevant to the circumstances of the audit and appropriate. The auditing guidance in this document has been reviewed by the AICPA Audit and Attest Standards staff and published by the AICPA and is presumed to be appropriate. This document has not been approved, disapproved, or otherwise acted on by a senior technical committee of the AICPA.

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## Acknowledgments

The AICPA staff is grateful to the following individuals for their essential contributions in creating this publication.

L. Michael Howard  
W. Michael Fritz  
Brian Schebler  
Flo Ostrum

Randy Roberts  
Donald L. Rahn  
Mandy Nelson  
Tom Scheidegger



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## How This Alert Helps You

**.01** This Audit Risk Alert (alert) helps you plan and perform your audits conducted in accordance with *Government Auditing Standards* (GAS or the Yellow Book) or Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (Circular A-133). Moreover, this alert delivers information about emerging practice issues and current accounting, auditing, and regulatory developments.

**.02** It is important that you understand what is happening in the *Government Auditing Standards* and OMB Circular A-133 arena if you perform Yellow Book or Circular A-133 audits. This alert assists you in making considerable strides in gaining an understanding of key developments regarding those audits.

**.03** Readers of this alert may also find the *AICPA Audit Risk Alert—2007/08* (product no. 022338kk) useful. Further, if you are also performing a financial statement audit of a state, local government, or not-for-profit organization, you should also refer to the following Audit Risk Alerts:

- AICPA Audit Risk Alert *State and Local Governmental Developments* (2007) (product no. 022437kk)
- AICPA Audit Risk Alert *Not-For-Profit Organizations Industry Developments* (2007) (product no. 022427kk)
- AICPA Audit Risk Alert *Health Care Industry Developments* (2007/08) (product no. 022346kk)

**.04** These alerts can be obtained by calling the AICPA at (888) 777-7077 or going online to [www.cpa2biz.com](http://www.cpa2biz.com). You should refer to the full text of accounting and auditing pronouncements as well as the full text of any rules or publications that are discussed in these alerts.

**.05 *References to Professional Standards.*** When referring to the professional standards, this alert cites the applicable sections as codified in the *AICPA Professional Standards* and not the numbered statements, as appropriate. For example, Statement on Auditing Standards (SAS) No. 54, *Illegal Acts by Clients*, is referred to as AU section 317 of the *AICPA Professional Standards*.

## Understanding the Entity, Its Federal Programs, and Assessing the Risks of Material Noncompliance

**.06** As noted in SAS No. 109, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* (AICPA, *Professional Standards*, vol. 1, AU sec. 314), an auditor must obtain a sufficient understanding of the entity and its environment, including its internal control, to assess the risks of material misstatement of the financial statements whether due to error or fraud, and to design the nature, timing, and extent of further audit procedures. The Audit Risk Alerts titled, *State and Local Governmental Developments* (2007), *Not-For-Profit Organizations Industry Developments* (2007/08), and *Health Care Industry Developments* (2007/08), further discuss the auditor's responsibilities in this area for a financial statement audit.

**.07** In a Circular A-133 audit it is also important to understand the entity subject to single audit and its federal programs, including its internal control

over compliance with those programs, to assess the risk of material noncompliance, and to design the nature, timing, and extent of further audit procedures. One of the auditor's initial tasks in the planning process of a single audit is determining whether management has properly defined the entity to be audited. Paragraph 6.11 of the AICPA Audit Guide Government Auditing Standards and Circular A-133 Audits (GAS/A-133 Guide) provides additional information on defining the entity to be audited, including the option for auditees to meet the requirements of the circular through a series of audits that cover an auditee's departments, agencies, and other organizational units that expended or otherwise administered federal awards during a fiscal year.

**.08** Further, Circular A-133 requires the auditee to maintain internal control over compliance for federal programs that provides reasonable assurance that the auditee is managing federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its federal programs. The auditor is required to perform procedures to obtain an understanding of internal control over compliance that is sufficient to plan the audit to support a low assessed level of control risk for major programs. The auditor needs to understand the assertions relevant to the compliance requirements for each major program. In obtaining the understanding, the procedures performed should provide sufficient knowledge of both the design of the relevant controls pertaining to each of the five internal control components (that is, control environment, risk assessment, control activities, information and communication, and monitoring) and whether they have been placed in operation. The auditor ordinarily obtains this knowledge through previous experience with the entity and through such procedures as inquiries of appropriate management, supervisory, or staff personnel; an inspection of the entity's documents and records; and his or her observation of the entity's activities and operations. Chapter 10 of the GAS/A-133 Guide further discusses the auditor's consideration and testing of internal control over compliance for major programs.

**.09** Finally, because Circular A-133 requires the auditor to determine whether the auditee has complied with laws, regulations, and the provisions of contracts or grant agreements that may have a direct and material effect on each of its major federal programs, the auditor should assess not only the risk that noncompliance may cause the financial statements to contain a material misstatement, but also the risk that noncompliance may have a material effect on each of its major programs. Chapter 8 of the GAS/A-133 Guide discusses audit risk as it relates to the compliance auditing of major programs.

## Industry Developments

**.10** From the standpoint of the federal user, audits conducted under Circular A-133 are a key accountability mechanism for the expenditure of taxpayer dollars. Recently, the results of a federal study on single audit quality were issued by the President's Council on Integrity and Efficiency (PCIE) and Executive Council on Integrity and Efficiency. The report titled, *Report on National Single Audit Sampling Project* (the PCIE report), identifies single audit quality deficiencies and shows that improvements are needed. The types of audit quality issues identified in the PCIE report are also consistent with the types of issues found in peer reviews of firms doing single audits and in investigations performed by the AICPA Professional Ethics Division (see "Other Reviews Indicate Continued Problems in GAS and Single Audits" in this alert).

.11 Consequently, as an auditor that performs single audits, you should review the PCIE report in detail to determine if the audit quality deficiencies cited in the report may affect the planning of your future engagements or your current audit methodologies and documentation practices. Further discussion of the results of the federal study is included in, "Results of Federal Study on Single Audit Quality" in this alert.

## Legislative and Regulatory Developments

.12 This section sets forth recent changes to relevant regulatory, legislative, and other guidance affecting GAS and Circular A-133 audits. In addition, it provides information on other legislative and regulatory developments.

## Results of Federal Study on Single Audit Quality

.13 The long-awaited federal study on the quality of audits performed under OMB Circular A-133 was issued on June 22, 2007. This section presents a background of the study, a summary of findings, a listing of some deficiencies noted, report recommendations, and highlights the AICPA and its Governmental Audit Quality Center's (GAQC) next steps to responding to the report.

.14 *Background.* Several years ago, a group of federal Offices of Inspectors General (OIGs), along with three state auditor's offices, decided to work together to develop a statistically based measure of single audit quality (the Project). The U.S. Department of Education served as the project leader. The project had two primary goals:

- Determine the quality of single audits and establish a statistically based measure of audit quality
- Recommend changes in single audit requirements, standards, and procedures to improve the quality of single audits

.15 To accomplish these goals, the OIGs conducted quality control reviews (QCRs) of a statistical sample of 208 audits randomly selected from approximately 38,000 audits submitted to and accepted by the Federal Audit Clearinghouse (FAC) between April 1, 2003 and March 31, 2004. Generally, the audits reviewed were from the 2002–2003 timeframe and, in some cases, earlier. The sample was split into two strata. Stratum I included audits of entities with \$50 million or more of total federal expenditures. Stratum II included audits of entities with at least \$500,000 but less than \$50 million of total federal expenditures.

.16 The scope of the project covered portions of the single audit relating to the planning, conduct, and reporting of audit work related to the review and testing of internal controls and compliance testing pertaining to compliance requirements for selected major federal programs. Documentation of audit work for up to three major programs for each audit was reviewed. Further, the review included audit work performed on the Schedule of Expenditure of Federal Awards (SEFA) and the content of all of the auditors' reports on the federal programs. The scope did not include a review of the content of, or the audit work performed, related to the general-purpose financial statements, the auditor's opinion on those statements, or the auditors' review of internal control over financial reporting.

**.17 Summary of Findings.** The issues and deficiencies identified in each QCR were compiled, and each engagement was then classified into one of three groupings. The groupings are defined as follows:

- Acceptable: No deficiencies were noted, or one or two insignificant deficiencies were noted. In some cases, the acceptable audits had deficiencies with applicable auditing criteria noted, which did not require corrective action, but should be corrected going forward.
- Limited Reliability: Significant deficiencies with applicable auditing criteria were noted and require corrective action to afford unquestioned reliance upon the entire audit.
- Unacceptable: Deficiencies were so serious that the auditor's opinion on at least one major program cannot be relied upon or a material reporting error was noted requiring that the report be reissued in order to be relied upon by users, or both.

**.18** The PCIE report clearly shows that improvements are needed in many areas. The tables shown below summarize the overall results and results by stratum. In addition to providing results by the number of audits reviewed, the OIGs also analyzed the results in relation to the dollar amounts of federal awards reported in the audits reviewed. Results in relation to dollar amounts reported in the audits reviewed show a much higher percentage of acceptability. The following tables show the results for both strata combined and then the results of Stratum I and Stratum II individually.<sup>1</sup>

<i><b>TOTAL SAMPLE (STRATA I &amp; II)</b></i>				
	<i><b>Acceptable</b></i>	<i><b>Limited Reliability</b></i>	<i><b>Unacceptable</b></i>	<i><b>Total</b></i>
Sampled Audits	115	30	63	208
% of Audits	49%	16%	35%	100%
% of Federal \$	93%	2%	5%	100%
<i><b>STRATUM I (&gt;\$50 Million in Federal Expenditures)</b></i>				
	<i><b>Acceptable</b></i>	<i><b>Limited Reliability</b></i>	<i><b>Unacceptable</b></i>	<i><b>Total</b></i>
Sampled Audits	61	12	23	96
% of Audits	64%	12%	24%	100%
% of Federal \$	93%	2%	5%	100%

<sup>1</sup> The report indicates the confidence parameter was 90 percent, and the precision parameters ranged between plus or minus 2.1 and 7.9 percentage points.

<b><i>STRATUM II</i></b> <b><i>(\$500 Thousand– \$50 Million in Federal Expenditures)</i></b>				
	<b><i>Acceptable</i></b>	<b><i>Limited Reliability</i></b>	<b><i>Unacceptable</i></b>	<b><i>Total</i></b>
Sampled Audits	54	18	40	112
% of Audits	48%	16%	36%	100%
% of Federal \$	56%	10%	34%	100%

**.19 Deficiencies Identified.** The PCIE report goes into detail regarding the deficiencies noted on the audits reviewed. The following presents a brief summary of deficiencies identified:

- Misreporting of audit coverage of major federal programs
- Unreported audit findings
- Compliance testing not documented as performed or not applicable
- Deficiencies in understanding and testing of internal control over compliance
- Deficiencies in risk assessments as part of major program determination
- Missing audit finding information
- Deficiencies in presentation and auditing of the SEFA
- Management representations related to federal awards missing or misdated
- Consideration of audit materiality at the major federal program level not documented
- Other kinds of deficiencies (described in Appendix A of the report)

**.20 PCIE Report Recommendations.** The PCIE report proposes a three-pronged approach for reducing the deficiencies noted and to improve the quality of single audits. The recommendations in the report are directed to various organizations including the OMB and other federal agencies, the AICPA, and other single audit stakeholders. A summary of the recommendations is as follows:

- Revise and improve single audit criteria, standards, and guidance to address deficiencies noted in the report. Specific recommendations are described throughout Part II and the "Other Matters" sections of the PCIE report and include recommendations for revisions to Circular A-133 and, in some cases, additions or clarifications to AICPA auditing standards and the GAS/A-133 Guide.
- Establish minimum requirements for completing comprehensive single audit training as a prerequisite for conducting such audits (the report suggests at least 16–24 hours) and thereafter, require single audit update training for continued performance of single audits.

- Review and enhance processes to address unacceptable audits and not meeting established training and continuing professional education requirements. This includes (a) reviewing the process of suspension and debarment; (b) identifying ways that the AICPA and State Boards of Accountancy can further the quality of single audits and address due professional care issues; and (c) identifying, reviewing, and evaluating the potential effectiveness of other ways to address unacceptable audits (these other ways could include sanctions to be applied to auditors or fines, or both).

**.21 Next Steps.** The AICPA shares the commitment of the federal agencies involved in the project to improving the quality of single audits. Many of the audits reviewed were performed 4–5 years ago, and the AICPA is hopeful that many endeavors over the last several years (for example, the launch of the GAQC) have already begun to address some of the issues raised in the PCIE report.

**.22** However, auditors should take this report very seriously and read the PCIE report in its entirety to determine if the audit quality deficiencies cited in the report may affect the planning of your future engagements or your current audit methodologies and documentation practices.

**.23** The AICPA and the GAQC Executive Committee and GAQC staff will be working closely with the federal government on a go-forward basis to address the PCIE report recommendations. During the course of the next year, auditors should watch the GAQC Web site at [www.aicpa.org/GAQC](http://www.aicpa.org/GAQC) for updates on initiatives undertaken by the AICPA and others in response to the PCIE report.

**Help Desk**—To access the PCIE report go to the following Web site: [www.ignet.gov/pande/audit/NatSamProjRptFINAL2.pdf](http://www.ignet.gov/pande/audit/NatSamProjRptFINAL2.pdf).

## Other Reviews Indicate Continued Problems in GAS and Single Audits

**.24** In addition to the PCIE report, the GAQC Web site contains a summary of common deficiencies noted in audits conducted in accordance with GAS and Circular A-133 and found during recent peer reviews and AICPA Professional Ethics Division investigations of CPA firms. A sampling of those deficiencies is included below. You should consider reviewing your firm's policies and procedures to determine whether your GAS and Circular A-133 audits might have these types of issues.

- Audit organizations did not submit their peer review report to required parties.
- The engagement team did not meet the *Government Auditing Standards* or state licensing board continuing professional education (CPE) requirements.
- The auditor used inadequate or outdated reference material related to the engagement performed. Be sure to be familiar with new SASs and accounting standards that are issued. Further, you



should ensure that you are using the most up-to-date versions of the *Compliance Supplement*, Yellow Book, and the GAS/A-133 Guide.

- The auditor did not use written audit programs or failed to tailor the audit programs for specialized industries or for specific transactions or balances (such as significant inventory and receivable balances).
- Audit documentation did not evidence when appropriate (1) the auditor's consideration of the existence of an internal audit function or the use of service organizations; (2) the auditor's reliance on the work of other auditors or of specialists; (3) the auditor's consideration of the client's internal control structure, the effect of the use of information technology on internal control, or the effect of internal control on substantive procedures; (4) the required communications between predecessor and successor auditors; and (5) adequate or complete documentation regarding engagement planning.
- In Circular A-133 audits, internal control and compliance tests were not always adequately documented to support the reports issued. In some cases the auditor did not document that an auditee was considered a low-risk auditee (to support the reduced testing that was performed). Further, in a few other cases, items such as the subsequent events review and litigation follow-up were not documented. AU section 339, *Audit Documentation* (AICPA, *Professional Standards*, vol. 1), provides guidance on the content, retention, and confidentiality of audit documentation as required by generally accepted auditing standards (GAAS). Among other things, AU section 339 requires audit documentation to be sufficient to enable members of the engagement team with supervision and review responsibilities to understand the nature, timing, extent, and results of auditing procedures performed and the evidence obtained. *Government Auditing Standards* includes an additional standard that requires audit documentation to contain sufficient information to enable an experienced auditor having no previous connection with the audit to ascertain the evidence that supports the auditor's significant conclusions and judgments. You should keep these AU section 339 and *Government Auditing Standards* requirements in mind when you are preparing your audit documentation. It is possible that problems with audit documentation could be the root of many of the other problems discussed in this section.
- The auditor did not assess the level of materiality or control risk.
- The auditor did not perform or document risk assessments for each of the five components of internal control or at the assertion level for major account balances or transaction classes.
- The auditor did not assess or document the risk of fraud, did not make appropriate inquiries, or did not adequately consider fraud risks in designing audit procedures.
- The auditor did not apply proper sampling techniques.



- Audit documentation did not indicate the disposition of prior audit findings and proper consideration of current potential significant deficiencies and other findings.
- The auditor failed to identify or address the client's incorrect application of generally accepted accounting principles (GAAP) or inadequate financial statement disclosure.
- The auditor did not request a legal representation letter when the client consulted an attorney and, in some cases, did not obtain a client management representation letter or did not include appropriate engagement-specific representations within the letter.
- The engagement letter did not include proper references to Circular A-133 requirements or record retention policies or include a copy of the latest peer review report.
- The auditor's reports did not conform to reporting requirements. For example, the reports omitted required wording or did not appropriately address other information accompanying the basic financial statements.
- Not all auditors are including all of the required finding elements in describing their findings for both GAS and Circular A-133 purposes. Among the required elements being left out of findings with respect to Circular A-133 are the Catalog of Federal Domestic Assistance (CFDA) number, federal award number, and year for each federal program. Chapter 5 of *Government Auditing Standards* and section 510(b) of Circular A-133 describes each of the elements that should be included in your findings. You should ensure that each of your findings contain the required elements.
- The auditor failed to audit as major programs type A programs not qualifying as low risk. Circular A-133 requires a type A program to be audited as a major program unless it qualifies as a low-risk program. For a program to be considered low risk, it must, among other criteria, have been audited as a major program in at least one of the two most recent audit periods. Auditors have made errors in applying this criterion. No auditor judgment is permitted in evaluating this historical two-year look-back criterion, and the reason a type A program was not audited in the prior two audit periods is irrelevant. Errors often occurred when a type A program was not audited in the first year it became a type A program (for example, a new program or a program that had previously been type B).
- The auditor failed to audit type A programs as major because of errors made in determining the type A/type B program dollar threshold.
- The auditor failed to audit all programs included in a cluster of programs. *Clusters* are defined in Part 5 of the supplement "Clusters of Programs," and should be considered as one program in determining major programs. Auditors made errors in identifying programs as part of a program cluster.
- The auditor failed to meet the percentage-of-coverage requirement in Circular A-133, section 520(f). The percentage-of-coverage requirement is applied as the last step in the risk-based approach and must always be met. At least one program must always be

audited as a major program. In some cases, there were errors in the reviewed audits' compliance with the percentage-of-coverage requirement.

- Sometimes the Circular A-133 report was not modified when it appeared that it should be. In other words, an unqualified opinion was provided when there were material instances of noncompliance. When the audit of an auditee's compliance with requirements applicable to a major program detects material instances of noncompliance with those requirements, you should express a qualified or adverse opinion. You should also consider whether the noncompliance is the result of a related reportable condition or material weakness and, if so, report it in the Circular A-133 reports.
- In some cases, the required compliance testing was not performed, sometimes because the auditor did not follow the guidance in Part 7 of the Compliance Supplement titled, "Guidance for Auditing Programs Not Included in This Compliance Supplement," for identifying the applicable compliance requirements to test and report on. In other cases, internal control and compliance tests were not adequately designed or documented to support the reports issued. In performing compliance tests, be sure that you have identified which of the applicable compliance requirements may have a direct and material effect on each major program. It is imperative that you use the most recent version of the supplement to make this identification. If the program you are auditing is not included in the supplement, you should follow the guidance in Part 7 of the supplement for identifying the applicable compliance requirements. Further, in performing compliance tests, be sure to consider relevant portions of the entity's internal control over compliance. Remember that you must test controls (to support a low assessed level of control risk for the assertions relevant to the compliance requirements for each major program) unless they are likely to be ineffective in preventing or detecting noncompliance.

**Help Desk**—The AICPA's GAQC (as discussed in "Governmental Audit Quality Center" in this alert) is the source of the above listing of common engagement deficiencies. Look under the "Resources" tab ([gaqc.aicpa.org/Resources/](http://gaqc.aicpa.org/Resources/)) and select either the "Audits Performed Under *Government Auditing Standards*" or "OMB Circular A-133" links.

## Office of Management and Budget Developments

### OMB Revises Circular A-133

.25 Auditor reporting required under OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, has been affected by the issuance of SAS No. 112, *Communicating Internal Control Related Matters Identified in an Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 325). On June 26, 2007, the OMB issued a Federal Register Notice titled Revisions

to OMB Circular A-133 (the OMB Notice) revising the circular to, among other things, adopt updated terminology consistent with SAS No. 112 requirements.

**.26** The OMB Notice has two main purposes: (1) to update the internal control terminology and related definitions used in Circular A-133; and (2) to simplify the auditee reporting package submission requirement to the FAC. With regard to terminology changes, the OMB Notice first states that to be consistent with professional auditing standards, when reporting on *internal control over financial reporting* in a financial statement audit required by Circular A-133, the references to *reportable conditions* and *material weaknesses* in the circular are replaced with the terms *significant deficiency* and *material weakness* as those terms are defined in SAS No. 112 and the 2007 revision to *Government Auditing Standards*. As for the auditor's reporting on internal control over compliance in a single audit, the OMB Notice states that the terms *reportable condition* and *material weakness* are replaced with the updated terminology and definitions in an AICPA Auditing Interpretation of SAS No. 112. These changes are effective for single audits of periods ending on or after December 15, 2006. Further discussion of the AICPA auditing interpretation and related illustrative auditor reports are included in "AICPA Issues Auditing Interpretation to Address SAS No. 112 Implications on Single Audits" in this alert. Further discussion of the 2007 revision to *Government Auditing Standards* is included in "Government Auditing Standards Developments" in this alert.

**.27** The OMB Notice acknowledges that the change in terminology and related definitions may result in the reporting of additional internal control matters and that the reporting of such additional matters may affect the scope of future single audits, particularly as it relates to the determination of major programs and the auditee's low-risk status.

**.28** Further, the OMB Notice also provided instructions on how to address the new internal control terminology in Form SF-SAC, "Data Collection Form for Reporting on Audits of States, Local Governments, and Non-Profit Organizations" (DCF or Data Collection Form) and an important change in the reporting package submission process. See "Data Collection Form and Reporting Package Submission Changes" in this alert for further information on these changes.

### ***Impact on Illustrative Schedule of Findings and Questioned Costs***

**.29** The illustrative Schedule of Findings and Questioned Costs (Example 12-5 in the GAS/A-133 Guide) should also be modified by auditors to replace the term *reportable condition* throughout the example with the term *significant deficiency* as it is updated in the 2007 edition of the GAS/A-133 Guide.

**Help Desk**—A PDF of the *Federal Register* notice is available at [www.whitehouse.gov/omb/grants/grants\\_docs.html](http://www.whitehouse.gov/omb/grants/grants_docs.html). As of the date of this alert, OMB has not yet incorporated the changes in the OMB Notice to the version of Circular A-133 on its Web site at [www.whitehouse.gov/omb/grants/grants\\_circulars.html](http://www.whitehouse.gov/omb/grants/grants_circulars.html). However, it is expected to do so soon.

## OMB Circular A-133 Compliance Supplement Update

**.30** The Circular A-133 *Compliance Supplement*, issued annually by OMB, identifies existing important compliance requirements that the federal government expects to be considered as part of an audit required by the Single Audit Act. For the programs it includes, the *Compliance Supplement* provides you with a source of information to understand the federal program's objectives, procedures, and compliance requirements relevant to the audit, as well as the audit objectives and suggested audit procedures for determining compliance with these requirements. For programs not listed in the *Compliance Supplement*, you should follow its Part 7, "Guidance for Auditing Programs Not Included in This Compliance Supplement," which instructs you to use the types of compliance requirements contained in the *Compliance Supplement* as guidance for identifying the types of compliance requirements to test, and to determine the requirements governing the federal program by reviewing the provisions of contracts and grant agreements and the laws and regulations referred to in such contracts and grant agreements.

**Help Desk**—The 2007 *Compliance Supplement* and two previous years' versions can be found on the OMB Web site at [www.whitehouse.gov/omb/grants/grants\\_circulars.html](http://www.whitehouse.gov/omb/grants/grants_circulars.html).

**.31** The OMB issued the 2007 *Compliance Supplement* dated March 2007. The 2007 *Compliance Supplement* is effective for audits of fiscal years beginning after June 30, 2006 and supersedes the *Compliance Supplement* issued in April 2006. Appendix V of the supplement, "List of Changes for the 2007 Compliance Supplement," is a key piece of information to identify all of the changes the OMB is making to the supplement.

**.32** Some of the more significant changes in the 2007 *Compliance Supplement* include the following:

- New programs were added as follows:
  - CFDA 14.169, Housing Counseling Assistance Program
  - CFDA 16.738 replaced 16.579, Byrne Formula Grant
  - CFDA 20.609, 20.610, 20.611, 20.612, and 20.613 were added to the Highway Safety Cluster
  - CFDA 84.032 covers the lender portion of 81.032, the Federal Family Education Loans (FFEL) program
- Two programs were deleted as follows:
  - CFDA 14.854, Public and Indian Housing Drug Elimination
  - CFDA 16.579 (see CFDA 16.738 above)
- In Part 2, "Matrix of Compliance Requirements," CFDA 10.500 added "subrecipient monitoring," and programs 10.665 and 10.666 removed the "Davis Bacon Act."
- Part 3, "Compliance Requirements," amended references to the various costs principles due to amendments effective in June 2004.

- There were extensive changes made to various programs in Part 4, "Agency Program Requirements."
- In Part 5, various changes were made to the Student Financial Assistance Cluster, including adding two programs, CFDA 84.375, Academic Competitiveness Grant, and CFDA 84.376, National Science and Mathematics Access to Retain Talent Grant. As noted above, five programs were added to the Highway Safety Cluster. Finally, the National Farmworker Jobs Cluster was removed.
- Appendix VI, which discusses special provisions related to Hurricanes Katrina and Rita, was revised.

### ***OMB Clarifies Compliance Supplement Guidance for Research and Development Cluster***

**.33** If you have clients that participate in federal Research and Development (R&D) programs, you should be aware that the OMB made a correction to the guidance in the 2007 *Compliance Supplement* for the R&D cluster relating to cost transfers after the *Compliance Supplement* had already been issued and posted for several months. The language that appeared in the 2006 *Compliance Supplement* on this topic should have been carried forward to the 2007 *Compliance Supplement*. However, due to an administrative error, it was changed. Upon being notified of the error, OMB corrected the language that originally was included in the 2007 supplement. The revised guidance appears in Part 5, *Clusters of Programs*, in the R&D cluster section on "Allowable Costs/Cost Principles" and reads as follows:

"Transfers of costs between cost centers or research projects are often used to correct the financial records (such as transfers of costs between projects when costs were initially charged to the wrong project and the institutions control system found the error) and for other valid reasons.

Cost transfers should be reviewed for allowability. A cost transfer from one project to another project may appear to be an unallowable charge to the second project. However, these costs may be allowable costs of the second project because of the closely linked nature of the research, and the costs would be allowable charges to either project. Alternatively, the transfers would not be allowable under the second project if the costs are not allowable under the terms and conditions of that project.

The auditor should determine if journal entries and transfers of costs were made to federal R&D projects. If so, the auditor should select a separate sample of these R&D cost transfers and test the sampled items to determine the allowability of the costs transferred using the applicable federal regulations and award requirements for the project to which the costs were transferred. If the number of cost transfers between unrelated projects is significant, this could be an indication of poor internal control and might result in a noncompliance finding."

**.34** If you are auditing R&D clusters as part of your single audits, check the *Compliance Supplement* section that you are using to be sure that the cost transfers guidance is the correct version (that is, that it includes the language above).

### ***OMB Leading Development of Web Site to Provide Data on Grants, Contracts, and Other Spending***

**.35** OMB has created an interim Web site at [www.federalspending.gov](http://www.federalspending.gov) to provide data on federal grants, contracts, and other spending in a searchable format. The purpose of this temporary Web site is to solicit feedback from the public on how to develop a search engine for the official Web site, which will be launched in January 2008. This entire effort is geared to satisfying the provisions of the Federal Funding Accountability and Transparency Act, which became law in 2006. Besides providing an opportunity for public comment and feedback, the site offers information and links to the Federal Funding Act (FFA), FFA task force implementation plan, answers to frequently asked questions, and links to information on federal spending.

### **Federal Audit Clearinghouse Topics**

**.36** The FAC operates on behalf of the OMB. Its primary purpose is to collect single audit and program-specific audit information and disseminate it to federal agencies and the public. Your clients are responsible for submitting the required reporting packages to the FAC, including the audit reports and the DCF. Auditors are required to complete Part I, Item 7, Part II, and Part III of the form before it is submitted with the reporting package.

**.37** Auditors can fill out and print the DCF on the FAC Web site at [harvester.census.gov/fac](http://harvester.census.gov/fac). This site also contains the form's instructions. The FAC encourages online completion and submission because the system provides edit checks that will increase the likelihood that the form will be accepted without errors.

**.38** There are separate forms for audits of fiscal periods ending in 2001–2003, and 2004–2006. Submissions covering fiscal periods with end dates before January 1, 2004 should use the prior version of the DCF. As noted in the following section, the 2004–2006 form should be used for audits covering fiscal periods ending in 2004, 2005, 2006, and 2007.

### ***Data Collection Form and Reporting Package Submission Changes***

**.39** As noted in "Office of Management and Budget Developments" in this alert, the OMB revised Circular A-133 primarily for needed revisions as a result of SAS No. 112. However, the OMB Notice that revised the circular also identified important information and updates relating to the DCF. The OMB Notice states that for single audits of periods ending December 15, 2006 through December 31, 2006, the approved DCF for fiscal years ending 2004, 2005, and 2006 should be used when filing with the FAC. The OMB Notice goes on to say that since the DCF has not yet been updated for the new internal control terminology, any *significant deficiency* should be recorded under the term *reportable condition* on the following items: Part II - items 3 and 4, Part III - items 4 and 5, and Part 3, item 10 (a). The OMB Notice states that the DCF approved for audits with fiscal period end dates in 2004, 2005, and 2006 has now also been extended to apply to audits with fiscal period end dates in 2007. All submissions with fiscal period end dates in 2007 must use the 2004–2006 version of the DCF. The DCF terminology will be updated in an upcoming revision to the form scheduled for January 1, 2008.

**.40** The OMB Notice also communicates a change relating to an auditee's submission of the reporting package to the FAC. Per the OMB, due to technology



advances, starting January 1, 2007, the auditee is no longer required to submit multiple copies of the reporting package to the FAC, in accordance with Section 320(d) of Circular A-133. Instead, only one copy of the reporting package is necessary. However, Part III, item 8, of the DCF should continue to be completed noting all agencies required to receive a copy of the reporting package.

### ***Data Collection Form and Reporting Package Submission Not Appropriate in Compliance Audits of For-Profits***

.41 Some for-profit entities are required by granting agencies through either a grant clause or contract to have a Circular A-133 audit (or an audit that is very similar to a Circular A-133 audit). The FAC has asked that auditors remind their for-profit clients that must undergo such an audit that they are **not** to send the DCF and the audit reporting package to the FAC. The package should be sent, however, to the requesting federal or state agency.

### ***Preparing the Data Collection Form***

#### **Basic Reporting Requirements**

.42 Your client is required to submit both the DCF and one complete copy of the reporting package FAC within 30 days of receipt of the auditor's reports, but no later than nine months after the end of its fiscal year. The DCF requires information regarding the period under audit, the client, the auditor, a summary of the client's federal expenditures, and a summary of the results of the audit.

.43 To take advantage of the online editing feature, the client is encouraged to use the Internet to enter the DCF data electronically. However, until the FAC receives an acceptable reporting package and the signed DCF, the client does not receive credit for meeting the submission requirement.

.44 The FAC has on its Web site frequently asked questions, which provide additional guidance on completing the form. The FAC also maintains an online database of audit submissions. See the following sections of this alert for additional discussion of the FAC, DCF, and how you can use the FAC database to help lessen the chance that your organization's audits have quality issues.

**Help Desk**—For questions about submitting the DCF and reporting packages, auditors may contact the FAC by e-mail at [govs.fac@census.gov](mailto:govs.fac@census.gov), by phone at (800) 253-0696, or by fax at (301) 457-1592. For questions regarding previous submissions, please call the FAC processing unit at (888) 222-9907.

### **Data Universal Numbering System Number Questions**

.45 The Data Universal Numbering System (DUNS) number field is one area of the 2004–2006 DCF that generates a lot of questions. A DUNS number is a nine-digit identification sequence assigned by Dun & Bradstreet. The instructions to the 2004–2006 DCF state that if your clients are considered to be a direct applicant (that is, the entity that made the grant application to the federal government, including state, local, and tribal governments, and other entities receiving block or other mandatory grants) they are requested to enter

their DUNS number(s) for submissions effective starting with submissions for fiscal periods ending in 2005. Questions have arisen as a result of a question and answer that appears in the "Frequently Asked Questions and Answers" document on the FAC's Web site. Question 21 addresses the issue of whether DUNS numbers are required. The answer states that the OMB requests, but does not require, a DUNS number to be entered for all entities submitting a DCF.

## Subrecipient Reporting Requirements

**.46** The DCF provides information on the results of the Circular A-133 audit and is entered into a database maintained by the FAC. Although both auditors and clients are required to complete parts of the DCF, the client is responsible for submitting both the DCF and the reporting package to the FAC. If your client is a subrecipient, it is also required to forward a copy of a reporting package to the pass-through entity (PTE) when the schedule of findings and questioned costs contains audit findings relating to federal awards provided by the PTE or when the summary schedule of prior audit findings reports the status of any audit findings relating to such awards. If the report contains no such findings, a subrecipient is required only to provide the affected PTEs with a notification that the audit was completed and that neither the schedule of findings and questioned costs nor the summary schedule of prior audit findings contained findings relating to the federal awards provided by the PTE.

## Common Reasons for Form Rejection

**.47** FAC representatives have identified a number of common faults that would cause the FAC to reject a filing. Most form errors are detected by edits and can be avoided when entering the data on the FAC Web site. Among these are the following:

- Part III, Item 8, "Federal Agency Distribution," is incorrect: A reporting package is distributed to federal agencies only if there are current year findings on directly funded programs, if the program is listed in the Schedule of Prior Year Findings, or they meet the threshold for coverage by a federal cognizant agency not covered by findings on direct funding.
- Part III, Item 9c, "Research and Development," is invalid (either blank or more than one box is checked).
- Part III, Item 9f, "Direct award," is invalid (either blank or more than one box is checked).
- Part III, Item 9a and 9b "CFDA Number," Multiple CFDA Numbers appear on one program line or an extra ' ' is included before the CFDA Extension.
- Missing audit components, especially a Corrective Action Plan (when required) from the auditee.
- Missing form signatures or signature dates.

## Tips on Reviewing Forms Before Submission

**.48** To avoid a DCF rejection, it is important for the form to be carefully reviewed by the auditor prior to its submission. Here are a few tips you can use within your practice to review the DCF before it is submitted to the FAC, and some "red flags" that can raise questions with federal OIGs.



**.49 Part II: Financial Statements.** Part II refers to the financial statement report and the report issued under *Government Auditing Standards*, not the reporting on internal control and compliance relating to federal programs. A tip for the person reviewing Part II is to simultaneously read the final auditor reports and the form to ensure this section is prepared using the final versions of the auditor reports and that the entries on the form are consistent with those reports.

**.50 Part III: Federal Programs.** In reviewing this section of the form, it is good practice to read the instructions to the DCF for Part III. Those instructions include useful information. Again, simultaneously reviewing the final Circular A-133 reporting and the form is good practice to ensure that the entries on the form are consistent with the results of the audit. Other tips for reviewing various items in this part follow.

- Item 7: This should be answered "no" if the summary schedule of prior audit findings indicates there were no prior audit findings.
- Item 8: It is important to ensure that all agencies affected by a cross-cutting finding are included. Also, the line "and, if not marked above, the federal cognizant agency" should not be checked if the client is too small to have a cognizant agency. Finally, it is important that the finding write-ups include all of the required elements, including the CFDA number, to ensure that Item 8 is properly completed.
- For Item 9 in this part, Column B should include the award number when the award does not have a three-digit CFDA extension.
- In Item 9: The programs should be listed in the same level of detail as in the SEFA. For instance, if the SEFA lists 10 Department of Health and Human Services (DHHS) awards within one or more CFDA numbers, Item 9 should list 10 DHHS awards; there should not be one total HHS line.
- Good practice is to prepare a written reconciliation between the total of Item 9(e) to the total of the schedule of federal award expenditures included in the Circular A-133 report. Common reconciling items include amounts that may be reported in the footnotes to the schedule of expenditures of federal awards. The following are examples:
  - Student loan outstanding balances
  - Administrative cost allowances
  - Commodities
  - Donated property
  - Interest subsidies
  - Insurance
- For Item 9, another good practice is for the reviewer to independently verify that Columns C, F, and G have been completed correctly. That is particularly true for very lengthy DCFs, as it is easy to inadvertently mark the wrong box.
- Item 10, Column A, should not include response P ("Other") very often. Sometimes, form preparers will tend to use "P" rather than

take the time to properly match a finding to the appropriate compliance requirement. If a "P" is noted as a response, extra attention may be needed to assure that the response is correct.

- Item 10, Column B, "Audit finding reference numbers," should reconcile to Item 8 in Part III, allowing only for differences relating to prior year findings covered in Item 8, but not in Item 10.

## Red Flags Raised by Incorrect Data Collection Forms

**.51** Federal OIGs sometimes review specific DCF data or use the FAC database to determine potential problems or issues with single audits that have been performed. Once potential problems are identified, the OIGs will likely contact the auditor for additional information or may decide to perform a quality control review of the engagement in question. For this reason, it is even more important that the DCF be completed correctly. The following are some of the red flags that incorrect DCF submissions might raise with federal reviewers:

- If the wrong box is checked in Part II, federal reviewers might conclude that the preparer did not understand the nature of the auditor's report that was issued.
- If the wrong boxes are checked in Part III, Items 1–8, federal reviewers might conclude that the auditor did not understand one or more of the following concepts: low risk auditee, type of report issued, or what belongs on the summary of prior audit findings.
- If Part III, Item 9, is not completed properly, the federal reviewer might conclude that the auditor did not understand the concept of "major programs," or that the auditor audited the incorrect major programs. Further, he or she might conclude that the auditor does not understand the nature of the findings reported.

## Revising a Data Collection Form Submission

**.52** For one reason or another, your client may need to revise a submission that has been made to the FAC. If this is the case, keep the following in mind:

- You must use a paper copy of the form (available at [harvester.census.gov/fac/collect/formoptions.html](http://harvester.census.gov/fac/collect/formoptions.html)).
- You should write "Revision" at the top of Page 1 and fill out Page 1 completely.
- You and the client should sign and date the form again.
- The client should fill out corrections/additions/deletions only.
- The client should retotal total federal awards expended (if needed).
- The client should send the paper form to FAC along with a cover letter summarizing the nature of the revision(s).
- The FAC Web site has instructions for such revisions.

## Using the FAC Database

**.53** You may find it worthwhile to investigate the FAC database. You can find instructions for its use on the FAC Web site at [harvester.census.gov/fac](http://harvester.census.gov/fac). The FAC expects that the major users of its database will be federal sponsoring agencies. A number of agencies report that they have found it useful,

for example, to compare the results of their own programmatic audits with those Circular A-133 audits performed by independent auditors and filed on the database. FAC officials also point out that you, as an auditor, can benefit from the database. For example, consider the following benefits:

- You and your clients can check on the status of submissions.
- You and your clients can ascertain the status of their subrecipients' submissions.
- You can perform overall analytical assessments of your organization's audits to determine, for example, whether there are any problems with the two-year look-back rule and major program determination. Although this is true, the FAC should not be the ones making this point.
- You can look at reports or findings related to programs you are auditing to supplement staff training.

## Government Auditing Standards Developments

.54 In July 2007, the U.S. Government Accountability Office (GAO) issued the July 2007 revision to *Government Auditing Standards* (GAO-07-731G). The July 2007 revision supersedes the 2003 revision and updates the January 2007 revision. The July 2007 revision contains the final 2007 revisions, including the quality control and peer review sections in Chapter 3, which GAO had exposed for comment in January 2007. The July 2007 revision represents the completed 2007 revision of *Government Auditing Standards* and is the version that should be used until further revisions or updates are made. It will be effective for financial audits and attestation engagements for periods beginning on or after January 1, 2008 and for performance audits beginning on or after January 1, 2008. Early implementation is encouraged. A downloadable version of the complete July 2007 revision is available on the GAO's Yellow Book webpage at [www.gao.gov/govaud/ybk01.htm](http://www.gao.gov/govaud/ybk01.htm). You will also find ordering information for the printed version on the GAO's Yellow Book webpage at [www.gao.gov/govaud/ybk01.htm](http://www.gao.gov/govaud/ybk01.htm).

.55 GAO has also issued a summary document titled, *Major Changes: July 2007 Revision to Government Auditing Standards* on its Web site at [www.gao.gov/govaud/somc0707.pdf](http://www.gao.gov/govaud/somc0707.pdf). This document highlights key revisions to the standards including those specifically related to ethics and independence, professional judgment and competence, all types of audits and attestation engagements performed under the Yellow Book, and financial and performance audits. The listing of changes is intended to assist practitioners in updating their related policies and procedures for conducting government audits. Among the significant changes in the July 2007 revision of *Government Auditing Standards* are the following:

### Overall Changes

.56 The July 2007 revision accomplished the following:

- Reinforced the key role of auditing in maintaining accountability and providing information for making improvements in government operations

- Clarified the standards through standardized language to define the auditor's level of responsibility and distinguish between auditor requirements and guidance/explanatory material. This approach is consistent with that being used by other auditing standard-setters
- Clarified and expanded the standards to recognize that other sets of professional standards, such as those issued by the Public Company Accounting Oversight Board (PCAOB), the International Auditing and Assurance Standards Board (IAASB), and the Institute of Internal Auditors (IIA) can be used in conjunction with generally accepted government auditing standards (GAGAS)

### ***Changes Related to Ethics and Independence***

**.57** The July 2007 revision also made changes related to ethics and independence:

- Heightened emphasis on ethical principles as the foundation, discipline, and structure behind the implementation of the standards, including a description of five key ethical principles that guide the work of those who conduct audits in accordance with GAGAS (Chapter 2 is devoted entirely to ethical principles.)
- Clarified and streamlined the discussion of professional services other than audit and attestation engagements (nonaudit services) and their impact on auditor independence by reorganizing the discussion and related examples into three distinct categories of nonaudit services
- Added guidance on actions required if an impairment to independence is identified after the audit report is issued

### ***Changes Related to Professional Judgment and Competence***

**.58** The July 2007 revision also includes changes related to professional judgment and competence:

- It stressed the critical role of professional judgment in all aspects of GAGAS audits, in considering risk, and in complying with GAGAS overall.
- It expanded the description of competence to emphasize its importance and relate it to key steps in performing an audit and reporting the findings and conclusions.
- It incorporated the revised CPE requirements that were issued by GAO in April 2005 (GAO-05-568G).
- It clarified the CPE requirement to include internal specialists who are part of the audit organization and perform as a member of the team.

### ***Changes Related to Quality Control and Assurance***

**.59** The July 2007 revision made changes related to quality control and assurance:

- It clarified that an audit organization's noncompliance with the peer review requirements result in a modified GAGAS statement, while the audit organization's compliance (or noncompliance) with

the requirements for a system of quality control are tested and reported on as part of the peer review process and do not affect the GAGAS compliance statement.

- It clarified that an audit organization's system of quality control should also provide reasonable assurance that the organization and its personnel comply with professional standards and applicable legal and regulatory requirements.
- It clarified that the GAGAS requirements for a system of quality control are consistent with the AICPA proposed Statement on Quality Control Standards (SQCS), except that the GAGAS requirements state that reviews of the work and the report that are performed as part of supervision are not monitoring controls when used alone.
- It added a requirement for an audit organization to include policies and procedures in its system of quality control that collectively address (a) leadership responsibilities for quality within the audit organization; (b) independence, legal, and ethical requirements; (c) initiation, acceptance, and continuance of audit and attestation engagements; (d) human resources; (e) audit and attestation engagement performance, documentation, and reporting; and (f) monitoring of quality.
- It added a requirement for audit organizations to analyze and summarize the results of its monitoring procedures at least annually, with identification of any systemic issues needing improvement, along with recommendations for corrective action.
- It added a requirement for external audit organizations to make peer review reports publicly available and for internal audit organizations to provide a copy to those charged with governance.

### ***Changes Related to All Types of GAGAS Audits and Attestation Engagements***

**.60** The July 2007 revision also accomplished the following:

- It added guidance on citing GAGAS in the audit report.
- It defined those charged with governance consistent with SAS No. 114, *The Auditor's Communication With Those Charged With Governance* (AICPA, *Professional Standards*, vol. 1, AU sec. 380).
- It added a requirement that the audit organization establish information systems controls concerning accessing and updating electronically maintained audit documentation.
- It clarified reporting requirements for internal control deficiencies, fraud, illegal acts, violations of provisions of contracts or grant agreements, and abuse.
- It clarified and streamlined several other areas relating to audit and attestation engagements, one of which is requirements and guidance for developing elements of a finding.

### ***Changes Related to Internal Auditors***

**.61** The July 2007 revision also included the following:

- Several changes to the guidance for internal auditors and encourages internal auditors to use IIA standards in conjunction with GAGAS

### ***Changes Related to Financial Audits***

**.62** The July 2007 revision further provided the following:

- It updated the financial auditing standards based on recent developments in financial auditing and internal control including SAS No. 103, *Audit Documentation* (AICPA, *Professional Standards*, vol. 1, AU sec. 339), and SAS No. 112.
- It clarified that professional judgment is used in determining whether and how to communicate deficiencies in internal control that are not significant deficiencies.
- It added requirements for reporting on the restatement of previously-issued financial statements.
- It encouraged communicating in the audit report significant concerns, uncertainties, or other unusual or catastrophic events that could have a significant impact on the financial condition or operations of a government entity or program for financial audits.

### ***Changes Related to Attestation Engagements***

**.63** The July 2007 revision made the following changes as they relate to attestation engagements:

- It clarified and revised the description of attestation engagements and included additional examples of types of attestation engagements.
- It conformed attestation engagements standards and guidance for consistency with changes in financial audits.

### ***Changes Related to Performance Audits***

**.64** The July 2007 revision further provided the following:

- It clarified and revised the definition of performance audits and included additional examples of types of performance audits.
- It enhanced performance auditing standards to elaborate on the overall framework for high-quality performance audits and clarified and expanded information on other performance auditing issues.

### ***Changes Related to Guidance Material***

**.65** The July 2007 revision also accomplished the following:

- It added an appendix to provide supplemental guidance to assist auditors in the implementation of GAGAS. This guidance does not establish additional GAGAS requirements but is intended to assist auditors in their work.

### **Effective Dates**

**.66** As noted above, the 2007 revision is effective for financial statement audits and attestation engagements for periods beginning on or after January 1, 2008 and for performance audits beginning on or after January 1, 2008. Certain standards issued by the AICPA incorporated by reference into the 2007 revision have earlier effective dates. The GAO has indicated that for financial statement audits conducted under *Government Auditing Standards*, the effective dates of those AICPA standards will apply.

**.67** The GAO has indicated that until the 2007 revisions become effective, auditors should adopt the terminology and definitions contained in SAS No. 112 when reporting on internal control deficiencies and include in their reports material weaknesses and significant deficiencies. GAO is also encouraging auditors to implement relevant sections of the 2007 revision for financial audits concurrent with the implementation of the related Auditing Standards Board (ASB) standards.

**.68** Additionally, GAO states that the 2007 revision should be used in conjunction with the following guidance documents, which are also available on the Yellow Book webpage at [www.gao.gov/govaud/ybk01.htm](http://www.gao.gov/govaud/ybk01.htm):

- Government Auditing Standards: Answers to Independence Questions (GAO-02-870G, July 2002)
- Government Auditing Standards: Guidance on GAGAS Requirements for Continuing Professional Education (GAO-05-568G, April 2005).

**Help Desk**—Two examples of the report on internal control over financial reporting and on compliance and other matters using language as defined in SAS No. 112 are available on the GAQC's Web site.

**.69** The GAO also plans to issue on its Web site a Professional Requirements Tool. The tool will provide a listing of the professional responsibilities from the 2007 revision that are specifically identified in the standards by the words "must" and "should."

## **U.S. Department of Housing and Urban Development Update**

### **HUD Consolidated Audit Guide Revisions**

**.70** The U.S. Department of Housing and Urban Development (HUD) continues its chapter-by-chapter process to update the Consolidated Audit Guide for Audits of HUD Programs, Handbook 2000.04 REV-2 CHG-1 (HUD audit guide). Presented below is a summary of the changes issued through the date of this writing.



<b><i>Chapter</i></b>	<b><i>Date Issued</i></b>	<b><i>Effective for Audits With Fiscal Years Ending On or After</i></b>
Chapter 2, "Report Requirements and Sample Reports," Example B	March 14, 2007	March 31, 2007
Chapter 2 Example B-1	March 14, 2007	March 31, 2007
Chapter 5, "Insured Development Cost Certification Audit Guidance"	March 23, 2007	June 30, 2007
Chapter 6, "Ginnie Mae Issuers of Mortgage-Backed Securities Audit Guidance"	April 3, 2007	June 30, 2007
Chapter 7, "HUD-Approved Title II"	April 27, 2007	June 30, 2007
Chapter 8, "HUD-Approved Title I"	September 1, 2006	December 31, 2006

**.71** Auditors should review the transmittals announcing the issuance of each of the above chapters on the HUD OIG Web site at [www.hud.gov/offices/oig/reports/auditguide/](http://www.hud.gov/offices/oig/reports/auditguide/) for a summary of the revisions made to each chapter.

**.72** The following chapters have yet to be revised or written.

<b><i>Chapter</i></b>	<b><i>Comment</i></b>
Chapter 1, "General Audit Guidance"	Revision in process.
Chapter 2, "Reporting Requirements and Sample Reports" (excluding Example B and B-1 which have already been revised (see table above))	Revision in process.
Chapter 3, "HUD Multifamily Housing Programs"	In the current guide, Chapter 3 is in reserve, and multifamily housing programs are covered in Chapter 4. HUD plans to move the multifamily housing program guidance to Chapter 3. Chapter 3 is in the process of being revised.
Chapter 4	This chapter is reserved to provide guidance on insured hospitals to address the many questions and concerns regularly received from auditors and managers on hospital audits. Development of this chapter has not been started.



.73 Auditors should periodically check HUD's Web site at [www.hud.gov/offices/oig/reports/auditguide/](http://www.hud.gov/offices/oig/reports/auditguide/) to make certain that they identify and follow the relevant audit guidance. The GAQC Web site will also provide status updates on future HUD revisions to the HUD audit guide.

## **HUD's Consolidated Audit Guide Incorrectly Used for Circular A-133 Purposes**

.74 According to the HUD OIG's office, some auditors have been incorrectly using the HUD audit guide to satisfy OMB Circular A-133 audits requirements of not-for-profit entities participating in Federal Housing Administration (FHA)/HUD's multifamily housing programs. The HUD audit guide is in the process of being updated (see previous section) and is not intended to be a program-specific audit guide that would satisfy Circular A-133 requirements by itself. Although Circular A-133, section 235(a) states that the auditor should contact the OIG to determine whether a current guide exists, HUD reports that no such contacts have been made. HUD indicates that if auditors use the HUD audit guide, it is their responsibility to assure that all Circular A-133 requirements as contained in the Circular and in the *Compliance Supplement* are covered.

## **Multifamily Audits Where Agents/Owners Manage Multiple Insured Projects**

.75 For situations where audit management agents and owners (not-for-profit and for-profit) manage many multifamily insured projects, auditors should be aware that the HUD audit guide is intended to cover the activities of a single project/entity and not the activities of the owner or the management agent. Some auditors have reviewed internal controls of the owner/agent and not of the project. Also, some auditors have not covered compliance requirements of each project but tested requirements of some projects and (1) if acceptable, accepted the results for all projects without disclosure in the projects' audit reports that certain projects were not tested, and (2) if deficiencies were found in the projects tested, those deficiencies were reported only in the tested projects' audit reports and not in all reports that were to be represented by the testing performed. HUD OIG has concluded that insufficient audit work was performed to support the opinion of many of the projects managed by the owner/agent. When HUD completes its revision to Chapter 3 of the HUD audit guide, it will prohibit this type of testing application. However, as part of that revision, HUD is also reviewing areas that can be tested at the owner/agent level if certain operating conditions exist. Also, HUD is reviewing various methods of sampling applications for inclusion in the revision to Chapter 3 to assure that the opinions upon which HUD relies are supportable.

## **Deficiencies in HUD Audits**

.76 In some cases, for-profit organizations, not-for-profits, and public housing authorities (PHAs) and their auditors have not followed the requirements outlined in HUD's *Guidelines on Reporting and Attestation Requirements of Uniform Financial Reporting Standards (UFRS) for Public Housing Authorities, Not-for-Profit Multifamily Program Participants, For-Profit Multifamily Program Participants, and Their Independent Accountants*. This HUD document provides guidance to PHAs and multifamily participants receiving HUD financial assistance and their auditors in meeting HUD audit reporting

requirements and requirements for filing financial information electronically with the HUD Real Estate Assessment Center. Specific problems identified include the omission of the required supplemental schedules and omission of required AU section 551, *Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents* (AICPA, *Professional Standards*, vol. 1), reporting on these schedules.

**.77** HUD's settlements with six firms since 2003 reinforce the federal government's strong emphasis on ensuring financial accountability and the importance of firms taking appropriate steps to ensure that they do not have any quality issues. Other steps HUD has taken in this regard include the following:

- Referrals to state boards of accountancy and the AICPA
- New methods of audit verification (that is, HUD staff reperforms a portion of the Circular A-133 audit at PHAs to determine whether the PHAs' audit firms identified all material instances of noncompliance with federal laws, regulations, and contract provisions occurring at the agency.)

## Other Regulatory Activity

### USDA Rural Rental Housing and Rural Labor Housing Programs

**.78** The USDA Office of Rural Development (RD) recently issued a letter to its state directors informing them that the financial reporting and audit requirements for the Rural Rental Housing (RRH) Program and the Rural Labor Housing (RLH) Program are changing effective for projects with December 31, 2007 year-ends. You can access the letter issued August 29, 2007, at the following Web site: [www.rurdev.usda.gov/regs/ul/ulaugust07.pdf](http://www.rurdev.usda.gov/regs/ul/ulaugust07.pdf). If your firm has clients that participate in these programs, you should pay close attention to the new requirements.

**.79** Those firms having clients that participate in the previously described programs know that it was not that long ago that the USDA Office of Inspector General (OIG) issued audit guidance titled, *Audit Program, USDA Rural Rental Housing Program*, which can be accessed at [www.usda.gov/oig/webdocs/FINALAUDPROG050414.pdf](http://www.usda.gov/oig/webdocs/FINALAUDPROG050414.pdf), that deleted the financial statement audit requirement and, instead, required an agreed-upon procedures engagement for the RRH program. For that reason, the GAQC staff verified the authoritative status of the new USDA RD audit guidance with the USDA OIG. The OIG stated that although it has not approved or sanctioned the new guidance, they will not impede its implementation at this time. Therefore, you should use the new guidance in lieu of the previous RRH Audit Program. However, you should also note that the OIG cautioned that the guidance in the previously issued Audit Program for Construction Cost Engagements continues to be effective.

**.80** Among other things, the new RD guidance will reinstate a financial statement audit requirement to be performed under *Government Auditing Standards* for borrowers with projects of 24 or more units. Further, borrowers with projects of 16 units or more will be required to undergo an additional agreed-upon procedures engagement. The RD guidance identifies three agreed-upon procedures that must be performed and promises additional guidance on testing criteria and procedures, sampling methodology and sample size, and standard reporting requirements. Borrowers with projects of 15 or fewer units are not subject to either the financial statement audit or agreed-upon

procedures requirement. Finally, all borrowers will have additional reporting requirements directly to USDA (for example, borrower certification of performance standards). The following table (which is excerpted from the guidance) summarizes the new requirements:

<i><b>Rural Development MFH Year End Financial Reporting Requirements</b></i>				
<i><b>Type of Property</b></i>	<i><b>Forms RD 3560-7 and 3560-10?</b></i>	<i><b>Borrower Certification of Performance Standards?</b></i>	<i><b>Agreed-Upon Procedures and Determinations*</b></i>	<i><b>Audited Financial Statements? (In Accordance With Yellow Book Standards)</b></i>
Rural Development Project (1–15 units)	Yes	Yes	No	No
Rural Development Project (16–23 units)	Yes	Yes	Yes	No
Rural Development Project (24+ units)	Yes	Yes	Yes	Yes*
State and local governments, Indian tribes, and Non-profit Organizations (subject to OMB Circular A-133)	Yes	Yes	No	No**
* Must be completed by a CPA. ** This Audit is in Accordance with OMB Circular A-133 and submitted to the Agency as <b>part</b> of the Financial Reporting Requirements.				

**.81** The guidance also provides several examples to further illustrate the above requirements as follows:

- A project of 36 units owned by a limited partnership must provide the self-certification, the budget and balance sheet forms, the agreed-upon procedures, and the financial audit.
- A for-profit borrower with an 8-unit project must provide the self-certification and the two forms.
- A for-profit borrower with a 20-unit property will provide the self-certification, the two forms, and the agreed-upon procedures.

- A nonprofit housing authority, subject to OMB Circular A-133, with a 24-unit property, will provide a copy of that report, the self-certification, and the two forms.
- A nonprofit borrower not subject to A-133 with a 16-unit property will provide the self-certification, the two forms, and the agreed-upon procedures.

.82 You should periodically check the RD "regulations" section of the USDA Web site for updates at [www.rurdev.usda.gov/regs/](http://www.rurdev.usda.gov/regs/).

## Department of Education Amends Student Financial Assistance Guide to Reflect Two New Programs

.83 If your firm audits for-profit postsecondary institutions or servicers, you should be aware that in September, the U.S. Department of Education (ED) issued interim guidance to amend the January 2000 Audit Guide *Audits of Federal Student Financial Assistance Programs at Participating Institutions and Institution Servicers* (SFA Guide). The guide can be found at [www.ed.gov/about/offices/list/oig/nonfed/sfgd2000.pdf](http://www.ed.gov/about/offices/list/oig/nonfed/sfgd2000.pdf). The purpose of the guidance is to recognize two new financial aid programs—the Academic Competitiveness Grant (ACG) Program and the National Science and Mathematics Access to Retain Talent Grant (National SMART Grant) Program.

.84 The guidance was issued in the form of a "Dear CPA Letter" and can be accessed at [www.ed.gov/about/offices/list/oig/nonfed/dearcpa0701.pdf](http://www.ed.gov/about/offices/list/oig/nonfed/dearcpa0701.pdf). ED issued the guidance in this interim format because it is in the process of working on a more comprehensive revision to the SFA Guide to reflect changes in the Federal Student Aid programs. In the meantime, ED wants to ensure audit coverage of the ACG Program and the National SMART Grant Program before the complete revised SFA Guide is issued.

.85 The ED guidance provides background information on each of the new programs. It also includes required procedures for each program that are mandatory for all audits conducted using the SFA Guide for audits with field work starting on or after (or still being conducted) 15 calendar days after the date of the issuance of the amendment (that is, 15 calendar days after issuance date of August 30, 2007), if the client institution participated, or should have participated, in either of the new programs in audit periods ending after June 30, 2006. Two of the required procedures are also applicable for audits of servicers who service schools participating in the two new programs.

.86 Watch the GAQC Web site for updates and information on the more comprehensive revision to the SFA Guide.

## Recent Auditing and Attestation Pronouncements and Related Guidance

.87 Presented in the following table is a list of recently issued auditing and attestation pronouncements and related guidance. Although some do not specifically address issues associated with your single audits, you should still be aware of them as they could affect the work you do on the financial statement audit portion of the single audit. You can look to the Audit Risk Alerts *State and Local Governmental Developments* (2007), *Not-For-Profit Organizations Industry Developments* (2007/08), and *Health Care Industry Developments* (2007/08) for further discussion of the financial statement audit implications of

these standards. We are only describing in more detail below those standards that may have some impact on your single audits.

.88 For information on auditing and attestation standards issued subsequent to the writing of this alert, please refer to the AICPA Web site at [www.aicpa.org/Professional+Resources/Accounting+and+Auditing](http://www.aicpa.org/Professional+Resources/Accounting+and+Auditing). You may also look for announcements of newly issued standards in the *CPA Letter, Journal of Accountancy*, and in the quarterly electronic newsletter, *In Our Opinion*, issued by the AICPA Auditing Standards team, available at [www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/Opinion](http://www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/Opinion). The GAQC Web site at [www.aicpa.org/GAQC](http://www.aicpa.org/GAQC) is also a useful Web site to look for updates. As a reminder, AICPA auditing and attestation standards are applicable only to audits and attestation engagements of nonissuers.

***Recent Auditing and Attestation Pronouncements  
and Related Guidance***

<p>SAS No. 114, <i>The Auditor's Communication With Those Charged With Governance</i> (AICPA, <i>Professional Standards</i>, vol. 1, AU sec. 380) Issue Date: December 2006 (Applicable to audits conducted in accordance with Generally Accepted Auditing Standards [GAAS])</p>	<p>This standard replaces SAS No. 61, <i>Communication With Audit Committees</i> (AICPA, <i>Professional Standards</i>, vol. 1, AU sec. 380A). The standard requires the auditor to conduct two-way communication with those charged with governance about certain significant matters related to the audit and also establishes standards and provides guidance on which matters should be communicated, who they should be communicated to, and the form and timing of the communication. It is effective for periods beginning on or after December 15, 2006.</p>
<p>SAS No. 113, <i>Omnibus Statement on Auditing Standards—2006</i> (AICPA, <i>Professional Standards</i>, vol. 1) Issue Date: November 2006 (Applicable to audits conducted in accordance with GAAS)</p>	<p>This standard:</p> <ul style="list-style-type: none"><li>• Revises the terminology used in the 10 standards of SAS No. 95, <i>Generally Accepted Auditing Standards</i> (AICPA, <i>Professional Standards</i>, vol. 1, AU sec. 150A), to reflect terminology in SAS No. 102, <i>Defining Professional Requirements in Statements on Auditing Standards</i> (AICPA, <i>Professional Standards</i>, vol. 1, AU sec. 120);</li><li>• Adds a footnote to the headings before paragraphs 35 and 46 in SAS No. 99, <i>Consideration of Fraud in a Financial Statement Audit</i> (AICPA, <i>Professional Standards</i>, vol. 1, AU sec. 316), to provide a clear link between the auditor's consideration of fraud and the auditor's assessment of risk and the auditor's procedures in response to those assessed risks;</li></ul>

***Recent Auditing and Attestation Pronouncements  
and Related Guidance—continued***

	<ul style="list-style-type: none"> <li>• Replaces throughout the SASs the term <i>completion of fieldwork</i> with the term <i>date of the auditor's report</i>; and</li> <li>• Changes the convention for dating the representation letter by requiring that it be dated as of the date of the auditor's report.</li> </ul>
SAS Nos. 104–111, the risk assessment standards Issue Date: March 2006 (Applicable to audits conducted in accordance with GAAS)	See "AICPA Risk Assessment Standards" in this alert.
SAS No. 112, <i>Communicating Internal Control Related Matters Identified in an Audit</i> (AICPA, <i>Professional Standards</i> , vol. 1, AU sec. 325) Issue date: May 2006 (Applicable to audits conducted in accordance with GAAS)	This standard supersedes SAS No. 60, <i>Communication of Internal Control Related Matters Noted in an Audit</i> . It establishes requirements and provides extensive guidance about communicating matters related to an entity's internal control over financial reporting identified while performing an audit of financial statements. SAS No. 112 also requires that certain communications be in writing. It is effective for periods ending on or after December 15, 2006.
SAS No. 103, <i>Audit Documentation</i> (AICPA, <i>Professional Standards</i> , vol. 1, AU sec. 339) Issue date: December 2005	SAS No. 103 supersedes SAS No. 96, <i>Audit Documentation</i> (AICPA, <i>Professional Standards</i> , vol. 1, AU sec. 339) and amends AU section 530, <i>Dating of the Independent Auditor's Report</i> (AICPA, <i>Professional Standards</i> , vol. 1). Effective for audits of financial statements for periods ending on or after December 15, 2006, with earlier application permitted, this SAS establishes standards and provides guidance to an auditor of a nonissuer on audit documentation.
Statements on Standards for Attestation Engagements (SSAE) No. 14, <i>SSAE Hierarchy</i> (AICPA, <i>Professional Standards</i> , vol. 1, AT sec. 50) Issue Date: November 2006	This SSAE identifies the body of attestation literature, clarifies the authority of attestation publications issued by the AICPA and others, specifies the extent of familiarity a practitioner needs to have with various kinds of attestation publications when conducting an attestation engagement, and amends the 11 attestation standards to reflect the terminology used in SSAE No. 13, <i>Defining Professional Requirements in Statements on Standards for Attestation Engagements</i> (AICPA, <i>Professional Standards</i> , vol. 1, AT sec. 20). It is effective for periods ending on or after December 15, 2006.

*(continued)*

**Recent Auditing and Attestation Pronouncements  
and Related Guidance—continued**

<p>Interpretation No. 1, "Communicating Deficiencies in Internal Control Over Compliance in an Office of Management and Budget (OMB) Circular A-133 Audit" (AICPA, <i>Professional Standards</i>, vol. 1, AU sec. 9325.01-.04), which interprets AU section 325, <i>Communicating Internal Control Related Matters Identified in an Audit</i> (AICPA, <i>Professional Standards</i>, vol. 1)</p> <p>Issue Date: July 2007 (Interpretive publication)</p>	<p>This auditing interpretation interprets AU section 325, <i>Communicating Internal Control Related Matters Identified in an Audit</i> (AICPA, <i>Professional Standards</i>, vol. 1), and addresses how the definitions of the terms <i>control deficiency</i>, <i>significant deficiency</i>, and <i>material weakness</i> should be adapted and applied in the context of reporting on internal control over compliance in a single audit.</p>
<p>Interpretation No. 1, "Use of Electronic Confirmations" (AICPA, <i>Professional Standards</i>, vol. 1, AU sec. 9330.01-.06), which interprets AU section 330, <i>The Confirmation Process</i> (AICPA, <i>Professional Standards</i>, vol. 1)</p> <p>Issue Date: March 2007 (Interpretive publication)</p>	<p>This auditing interpretation interprets AU section 330, <i>The Confirmation Process</i> (AICPA, <i>Professional Standards</i>, vol. 1), and addresses the issue of electronic confirmations.</p>
<p>AICPA Technical Practice Aid (TPA) Technical Questions and Answers (TIS) section 9100.06, "The Effect of Obtaining the Management Representation Letter on Dating the Auditor's Report" (AICPA, <i>Technical Practice Aids</i>)</p> <p>Issue Date: May 2007 (Nonauthoritative)</p>	<p>This question and answer discusses whether the auditor is required to have the signed management representation letter in hand as of the date of the auditor's report. The question and answer indicates that although the auditor need not be in physical receipt of the representation letter on the date of the auditor's report, management will need to have reviewed the final representation letter and, at a minimum, have orally confirmed that they will sign the representation letter, without exception, on or before the date of the representations.</p>
<p>AICPA TPA TIS section 8350.01, "Current Year Audit Documentation Contained in the Permanent File" (AICPA, <i>Technical Practice Aids</i>)</p> <p>Issue Date: May 2007 (Nonauthoritative)</p>	<p>This question and answer discusses whether the provisions of SAS No. 103, <i>Audit Documentation</i> (AICPA, <i>Professional Standards</i>, vol. 1, AU sec. 339), related to documentation completion and retention, apply to current year audit documentation maintained in the permanent file. This question and answer indicates that SAS No. 103 does apply to current year audit documentation maintained in a permanent file, or for that matter, maintained in any type of file, if the documentation serves as support for the current year's audit report.</p>



***Recent Auditing and Attestation Pronouncements  
and Related Guidance—continued***

<p>AICPA Professional Issues Task Force (PITF) Practice Alert (PA) 03-1, <i>Audit Confirmations</i> (AICPA, <i>Technical Practice Aids</i>, PA sec. 16,240) Revised: June 2007 (Nonauthoritative)</p>	<p>This practice alert responds to practitioners' current concerns about audit confirmations and includes discussion of improving confirmation response rates, negative versus positive confirmation requests, nonresponses to positive confirmations, responses to positive confirmation requests indicating exception, and use of electronic confirmations among other topics.</p>
<p>AICPA PITF PA 07-1, <i>Dating of the Auditor's Report and Related Practical Guidance</i> (AICPA, <i>Technical Practice Aids</i>, PA sec. 16,290) Issue Date: January 2007 (Nonauthoritative)</p>	<p>This practice alert provides guidance regarding application of certain provisions of SAS No. 103, primarily related to dating the auditor's report.</p>

## **The Auditor's Communication With Those Charged With Governance**

**.89** In December 2006, the ASB issued SAS No. 114, *The Auditor's Communication With Those Charged With Governance* (AICPA, *Professional Standards*, vol. 1, AU sec. 380), which supersedes SAS No. 61, *Communication With Audit Committees* (AICPA, *Professional Standards*, vol. 1, AU sec. 380A). The new SAS establishes standards and provides guidance to auditors on matters required to be communicated with those charged with governance in relation to an audit of financial statements and is effective for audits of financial statements for periods beginning on or after December 15, 2006. SAS No. 61 established communication requirements applicable to entities that either have an audit committee or that have otherwise formally designated oversight of the financial reporting process to a group equivalent to an audit committee. However, SAS No. 114 broadens the applicability of the SAS to audits of the financial statements of all nonissuers regardless of size, ownership, or organizational structure.

**.90** SAS No. 114 recognizes the importance of effective two-way communication to the audit. It provides a framework for the auditor's communication with those charged with governance and identifies specific matters to be communicated, many of which are generally consistent with the requirements in SAS No. 61. However, SAS No. 114 does include certain additional matters to be communicated and provides additional guidance on the communication process. Among other matters, SAS No. 114 adds requirements to communicate an overview of the planned scope and timing of the audit. It also requires significant matters communicated with those charged with governance to be documented.

### ***Identifying Those Charged With Governance***

**.91** The SAS uses the term *those charged with governance* to refer to those with responsibility for overseeing the strategic direction of the entity



and obligations related to the accountability of the entity, including overseeing the entity's financial reporting process. The SAS uses the term *management* to refer to those who are responsible for achieving the objectives of the enterprise and who have the authority to establish policies and make decisions by which those objectives are to be pursued.

**.92** The auditor should determine the appropriate person(s) within the entity's governance structure with whom to communicate. The appropriate person(s) may vary depending on the matter to be communicated. Governance structures vary by entity, reflecting influences such as size and ownership characteristics.

**.93** Since there is such diversity, it is not possible for SAS No. 114 to specify for all audits the person(s) with whom the auditor is to communicate particular matters. Furthermore, in some cases the appropriate person(s) with whom to communicate may not be clearly identifiable from the engagement circumstances, for example, entities where the governance structure is not formally defined, such as some family-owned entities, some not-for-profit organizations, and some government entities. Examples for state and local governmental entities might include governing boards, city councils, audit committees, mayors, governors, legislators, university/college presidents, and chancellors. The auditor's understanding of the entity's governance structure and processes obtained in accordance with SAS No. 109, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* (AICPA, *Professional Standards*, vol. 1, AU sec. 314), is relevant in deciding with whom to communicate matters. When the appropriate person(s) with whom to communicate are not clearly identifiable, the auditor and the engaging party should agree on the relevant person(s) within the entity's governance structure with whom the auditor will communicate.

## Communicating Internal Control Related Matters Identified in an Audit

**.94** In May 2006, the AICPA ASB issued SAS No. 112, *Communicating Internal Control Related Matters Identified in an Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 325). SAS No. 112 establishes standards and provides guidance on communicating matters related to an entity's internal control over financial reporting (internal control) identified in an audit of financial statements. SAS No. 112 supersedes SAS No. 60, *Communication of Internal Control Related Matters Noted in an Audit*, as amended. The new SAS is applicable whenever an auditor expresses an opinion on financial statements (including a disclaimer of opinion) and is effective for audits of financial statements for periods ending on or after December 15, 2006. Among other things, SAS No. 112 does the following:

- Requires the auditor to communicate control deficiencies that are *significant deficiencies* or *material weaknesses* in internal control. The terms are defined in the SAS. The term *reportable condition* is no longer used.
- Provides guidance on evaluating the severity of control deficiencies identified in an audit of financial statements and requires that the auditor conclude whether prudent officials, having knowledge of the same facts and circumstances, would agree with the auditor's classification of the deficiency.

- Identifies areas in which control deficiencies ordinarily are to be evaluated as at least significant deficiencies, as well as indicators that control deficiencies should be regarded as at least a significant deficiency and a strong indicator of a material weakness.
- Requires the auditor to communicate significant deficiencies and material weaknesses identified in the audit, in writing, to management and those charged with governance. This includes the significant deficiencies and material weaknesses that were communicated in previous audits if they have not yet been remediated.
- Indicates that the communication must be in writing and is best made by the report release date (the date on which the auditor grants permission for the client to use the auditor's report in connection with the financial statements), but should be made no later than 60 days following the *report release date*.
- Contains illustrative written communications to management and those charged with governance.

**.95** The AICPA has also published the AICPA Audit Risk Alert *Understanding SAS No. 112 and Evaluating Control Deficiencies* (product no. 022536kk) to assist in implementation of this SAS in a financial statement audit. This Audit Risk Alert provides specific case studies to help determine whether identified control weaknesses would constitute a significant deficiency or material weakness; it can be obtained by calling the AICPA at (888) 777-7077 or going online at [www.cpa2biz.com](http://www.cpa2biz.com).

**Help Desk**— The GAQC has provided a public link on its Web site to an archived conference call discussing SAS No. 112 and its impact on practice. You can find the link to the call at [gaqc.aicpa.org/Resources/Impact+of+SAS+112+on+Governmental+Financial+Audits+Conference+Call.htm](http://gaqc.aicpa.org/Resources/Impact+of+SAS+112+on+Governmental+Financial+Audits+Conference+Call.htm).

### ***AICPA Issues Illustrative Yellow Book Reports With SAS No. 112 Terminology***

**.96** The required *Government Auditing Standards* reporting is also affected by the issuance of SAS No. 112. As noted by GAO upon issuance of the 2007 revision to the Yellow Book, auditors should adopt the terminology and definitions in SAS No. 112 when reporting on internal control deficiencies (see also, "*Government Auditing Standards Developments*" in this alert). The GAQC has developed updated Yellow Book report illustrations that reflect the new SAS No. 112 terminology that can be found at [gaqc.aicpa.org/Resources/Illustrative+Auditors+Reports/#YB](http://gaqc.aicpa.org/Resources/Illustrative+Auditors+Reports/#YB). Those reports have been reviewed by GAO staff. The illustrative report examples, which update two illustrations that appear in the GAS/A-133 Guide, will ultimately be incorporated into the 2007 edition of the GAS/A-133 Guide when it is updated later this year. Further, two other reports in the GAS/A-133 Guide (Example 4-4 and 4-6) will be updated in the 2007 edition to reflect similar SAS No. 112.

## **AICPA Issues Auditing Interpretation to Address SAS No. 112 Implications on Single Audits**

**.97** The ASB has issued a final related audit interpretation to SAS No. 112 (AU section 9325.01–.03) titled, Auditing Interpretation No. 1, "Communicating Deficiencies in Internal Control Over Compliance in an Office of Management and Budget (OMB) Circular A-133 Audit" (AICPA, *Professional Standards*, vol. 1). As mentioned previously in "OMB Revises Circular A-133," in this alert, the issuance of this interpretation coincides with the issuance by OMB of a revision to Circular A-133 for the implications of SAS No. 112. The interpretation establishes definitions for the terms *control deficiency*, *significant deficiency*, and *material weakness* when the auditor is reporting control deficiencies that relate to internal control over compliance in a Circular A-133 audit. The terms and definitions included in the interpretation are as follows:

- A *control deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect on a timely basis noncompliance with a type of compliance requirement of a federal program.
- A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected.
- A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected.

## **Updated Circular A-133 Illustrative Single Audit Reports Issued to Incorporate SAS No. 112 Language**

**.98** The three Circular A-133 reports listed below have been updated for SAS No. 112 and are incorporated into the 2007 update to the GAS/A-133 Guide which is expected to be available in late 2007. GAS/A-133 Guide also includes other illustrative reports illustrating various compliance reporting situations that were also updated for SAS No. 112.

- Example 12-1. Report on Compliance With Requirements Applicable to Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133 (*Unqualified Opinion on Compliance and No Material Weaknesses [No Significant Deficiencies in Internal Control Over Compliance Identified]*).
- Example 12-2. Report on Compliance With Requirements Applicable to Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133 (*Unqualified Opinion on Compliance and Significant Deficiencies in Internal Control Over Compliance Identified*) [Note that this is a new report to reflect the most common situation for the reporting of significant deficiencies—that is, when the report on compliance is unqualified].

- Example 12-3. Report on Compliance With Requirements Applicable to Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133 (*Qualified Opinion on Compliance and Material Weaknesses in Internal Control Over Compliance Identified*) [Note that this report has been revised to reflect the most common situation for the reporting of material weaknesses—that is, when the report on compliance is qualified].

**Help Desk**—The GAQC has provided updated illustrative single audit reports that incorporate the new SAS No. 112 language on its Web site at [gaqc.aicpa.org/Resources/Illustrative+Auditors+Reports/#OMB](http://gaqc.aicpa.org/Resources/Illustrative+Auditors+Reports/#OMB)

### ***Guidance on Evaluating Control Deficiencies in a Single Audit***

**.99** As noted in SAS No. 112, the auditor must evaluate identified control deficiencies and determine whether these deficiencies, individually or in combination, are significant deficiencies or material weaknesses. However, the guidance in SAS No. 112 for evaluating control deficiencies is written from the perspective of a financial statement audit. The following guidance is intended to emulate the guidance in SAS No. 112 for your consideration when evaluating control deficiencies in a single audit.

**.100** In a single audit, the significance of a control deficiency depends on the potential for noncompliance, not on whether noncompliance actually has occurred. Accordingly, the absence of identified noncompliance does not provide evidence that identified control deficiencies are not significant deficiencies or material weaknesses. When evaluating whether control deficiencies, individually or in combination, are significant deficiencies or material weaknesses, the auditor should consider the likelihood and magnitude of actual or potential noncompliance.

**.101** The following are examples of factors that may affect the likelihood that a control, or combination of controls, could fail to prevent or detect noncompliance:

- The nature of the type of compliance requirement involved. For example, a specific special test or provision may involve greater risk because it is unique to the program and may require unique controls.
- The susceptibility of the program and related types of compliance requirements to fraud.
- The subjectivity and complexity involved in meeting the compliance requirement and the extent of judgment allowed.
- The cause and frequency of any known or detected exceptions related to the operating effectiveness of a control.
- The interaction or relationship of the control with other controls.
- The interaction of the control deficiency with other control deficiencies.
- The possible future consequences of the deficiency.

**.102** The evaluation of control deficiencies includes the magnitude of non-compliance. Several factors affect the magnitude of noncompliance that could result from a deficiency or deficiencies in controls. The factors may include, but are not limited to, the following:

- The program amounts or total of transactions exposed to the deficiency in relation to the type of compliance requirement
- The volume of activity related to the compliance requirement exposed to the deficiency in the current period or expected in future periods
- Adverse publicity or other qualitative factors

**.103** Multiple control deficiencies that affect the same type of compliance requirement increase the likelihood of noncompliance and may, in combination, constitute a significant deficiency or material weakness, even though such deficiencies are individually insignificant. Therefore, the auditor should evaluate individual control deficiencies that affect the type of compliance requirement, or component of internal control, to determine whether they collectively result in a significant deficiency or material weakness.

**.104** In determining whether a control deficiency or combination of control deficiencies is a significant deficiency or material weakness, the auditor also should evaluate the possible mitigating effects of effective compensating controls that have been tested and evaluated as part of the audit of the major program. A compensating control is a control that limits the severity of a control deficiency and prevents it from rising to the level of a significant deficiency or, in some cases, a material weakness. Compensating controls operate at a level of precision, considering the possibility of further undetected noncompliance, which would result in the prevention or detection of noncompliance that is more than inconsequential or material to the type of compliance requirement. Although compensating controls mitigate the effects of a control deficiency, they do not eliminate the control deficiency. The auditor could evaluate and test the effectiveness of a compensating control and determine whether it operates effectively for the purpose of mitigating the effects of the control deficiency in the type of compliance requirement.

**.105** The auditor may encounter deviations in the operating effectiveness of controls. A control that has an observed nonnegligible deviation rate is at least a control deficiency regardless of the reason for the deviation, and could be, based upon further evaluation, a significant deficiency or material weakness. For example, if the auditor designs a test in which he or she selects a sample and expects no deviations, the finding of one deviation is a nonnegligible deviation rate because based on the results of the auditor's test of the sample, the desired level of confidence was not obtained.

**.106** The auditor should conclude whether prudent officials, having knowledge of the same facts and circumstances, would agree with the auditor's classification of the deficiency. Although the term *prudent official* is not defined in the standard, the concept is that an auditor should "stand back" and take another objective look at the severity of the deficiency much as would a regulator or someone from an oversight agency.

**.107** For purposes of deficiencies in a single audit, the following areas ordinarily are at least significant deficiencies in internal control:

- Policies and procedures that are incomplete, inadequate, or outdated for the activities subject to a type of compliance requirement.
- Inadequate segregation of duties over a type of compliance requirement.
- Controls over complex types of compliance requirements.
- IT controls relating to the activity subject to the type of compliance requirement.

**.108** Each of the following is an indicator of a control deficiency that should be regarded as at least a significant deficiency and a strong indicator of a material weakness in internal control:

- Lack of operating policies and procedures for the activities subject to a type of compliance requirement.
- Ineffective oversight of a major federal program by those charged with governance over compliance with those program requirements where the activity is subject to the type of compliance requirement, for example, lack of adequate review of federal financial reports prior to submission to the grantor.
- Identification by the auditor of material noncompliance for the period under audit that was not initially identified by the entity's internal control. (This is a strong indicator of a material weakness even if management subsequently corrects the noncompliance.)
- An ineffective internal audit function or risk assessment function for a major program for which such functions are important to the monitoring or risk assessment component of internal control for a type of compliance requirement.
- Identification of fraud in the major program of any magnitude on the part of senior program management. For the purposes of evaluating and communicating deficiencies in internal control, the auditor should evaluate fraud of any magnitude—including fraud resulting in immaterial noncompliance—on the part of senior program management, of which he or she is aware.
- Failure by management or those charged with governance to assess the effect of a significant deficiency previously communicated to them and either correct it or conclude that it will not be corrected.
- An ineffective control environment. Control deficiencies in various other components of internal control could lead the auditor to conclude that a significant deficiency or material weakness exists in the control environment over compliance with major program requirements.

## AICPA Risk Assessment Standards

**.109** In March 2006, the AICPA ASB issued eight SASs referred to as the risk assessment standards (SAS Nos. 104–111) that are described in the following table. They are effective for audits of financial statements for periods beginning on or after December 15, 2006, with earlier applications permitted. The risk assessment standards were written from the perspective of a financial statement audit. The AICPA will be evaluating the new SASs and any potential



implications for audits performed under Circular A-133. Watch the GAQC Web site for further updates over the course of the next year.

<b><i>Statement on Auditing Standards</i></b>	<b><i>Effect on Existing Standards</i></b>
SAS No. 104, <i>Amendment to Statement on Auditing Standards No. 1, Codification of Auditing Standards and Procedures ("Due Professional Care in the Performance of Work")</i> (AICPA, <i>Professional Standards</i> , vol. 1, AU sec. 230)	This statement amends SAS No. 1, <i>Due Professional Care in the Performance of Work</i> (AICPA, <i>Professional Standards</i> , vol. 1, AU sec. 230A).
SAS No. 105, <i>Amendment to Statement on Auditing Standards No. 95, Generally Accepted Auditing Standards</i> (AICPA, <i>Professional Standards</i> , vol. 1, AU sec. 150)	This statement amends SAS No. 95, <i>Generally Accepted Auditing Standards</i> (AICPA, <i>Professional Standards</i> , vol. 1, AU sec. 150A).
SAS No. 106, <i>Audit Evidence</i> (AICPA, <i>Professional Standards</i> , vol. 1, AU sec. 326)	This statement supersedes SAS No. 31, <i>Evidential Matter</i> (AICPA, <i>Professional Standards</i> , vol. 1, AU sec. 326A).
SAS No. 107, <i>Audit Risk and Materiality in Conducting an Audit</i> (AICPA, <i>Professional Standards</i> , vol. 1, AU sec. 312)	This statement supersedes SAS No. 47, <i>Audit Risk and Materiality in Conducting an Audit</i> (AICPA, <i>Professional Standards</i> , vol. 1, AU sec. 312A).
SAS No. 108, <i>Planning and Supervision</i> (AICPA, <i>Professional Standards</i> , vol. 1, AU sec. 311)	This statement supersedes SAS No. 1, <i>Appointment of the Independent Auditor</i> (AICPA, <i>Professional Standards</i> , AU sec. 310), and supersedes SAS No. 22, <i>Planning and Supervision</i> (AICPA, <i>Professional Standards</i> , vol. 1, AU sec. 311A).
SAS No. 109, <i>Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement</i> (AICPA, <i>Professional Standards</i> , vol. 1, AU sec. 314)	This statement supersedes SAS No. 55, <i>Consideration of Internal Control in a Financial Statement Audit</i> (AICPA, <i>Professional Standards</i> , vol. 1, AU sec. 319).
SAS No. 110, <i>Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained</i> (AICPA, <i>Professional Standards</i> , vol. 1, AU sec. 318)	This statement supersedes SAS No. 45, <i>Substantive Tests Prior to the Balance Sheet Date</i> (AICPA, <i>Professional Standards</i> , vol. 1, AU sec. 313), and together with SAS No. 109, supersedes SAS No. 55, <i>Consideration of Internal Control in a Financial Statement Audit</i> (AICPA, <i>Professional Standards</i> , vol. 1, AU sec. 319).

<i>Statement on Auditing Standards</i>	<i>Effect on Existing Standards</i>
SAS No. 111, <i>Amendment to Statement on Auditing Standards No. 39, Audit Sampling</i> (AICPA, <i>Professional Standards</i> , vol. 1, AU sec. 350)	This statement amends SAS No. 39, <i>Audit Sampling</i> (AICPA, <i>Professional Standards</i> , vol. 1, AU sec. 350A).

## Audit Documentation

**.110** SAS No. 103, *Audit Documentation* (AICPA, *Professional Standards*, vol. 1, AU sec. 339), provides guidance on the form, content, retention, extent, and confidentiality of audit documentation as required by GAAS. Among other things, SAS No. 103 requires audit documentation to be sufficient to enable an experienced auditor, having no previous connection to the audit, to understand the nature, timing, extent, results, and conclusions of auditing procedures performed, and that the accounting records agree or reconcile with the audited financial statements or other audited financial information. SAS No. 103 contains guidance on documenting significant findings or issues; identifying the preparer and reviewer of audit documentation; documenting specific items tested; documenting departures from relevant SASs; revising audit documentation after the date of the auditor's report; and ownership and confidentiality of audit documentation.

**.111** It requires you to assemble, within 60 days following the delivery of the auditor's report to the entity, the audit documentation that forms the final audit engagement file. (Some states may require that this be done within a shorter period.) After that date, SAS No. 103 precludes you from deleting or discarding existing audit documentation, and requires that you appropriately document any subsequent additions or changes.

**.112** In developing this SAS, the ASB considered the documentation requirements of the PCAOB, the International Auditing and Assurance Standards Board, the GAO's *Government Auditing Standards*, and suggestions received from the National Association of State Boards of Accountancy. The SAS establishes standards and provides guidance to an auditor of a nonissuer regarding the audit documentation for audits of financial statements or other financial information being reported on. Audit reviewers consider audit documentation to be an essential element of determining audit quality, including the quality of audits conducted under GAS and Circular A-133. Evidence from quality control reviews and peer reviews clearly shows that problems with audit documentation may be the root of many quality problems. Therefore, you may want to consider spending some time considering the new requirements and your firm's policies and procedures relating to documentation. Some additional key areas of the SAS are as follows:

- It requires the auditor, when preparing audit documentation, to consider the needs of an "experienced auditor" having no previous connection with the audit, to understand the procedures performed, the evidence obtained, and the specific conclusions reached. That concept is likely to be familiar to you because GAS contains a similar requirement.
- It provides enhanced guidance concerning matters that should be documented and the retention of documentation.



- It requires you to document audit evidence that is contradictory or inconsistent with the final conclusions and how you addressed the contradiction or inconsistency.

**.113** We suggest that you consider this requirement as you develop your firm internal policies with regard to documentation. You should keep in mind that, in situations in which a single audit is performed later, after the completion of the financial statement audit, questions have arisen about how the 60-day requirement would apply to single audit documentation. While no authoritative guidance has been issued on this question yet, some are interpreting this to mean that the auditor would assemble, within 60 days following the delivery of the auditor's Circular A-133 report to the entity, the single audit documentation that forms the final single audit engagement file.

**.114** It specifies a minimum file retention period of five years from the date of the auditor's report. Some states have their own separate retention requirements that may extend beyond five years for auditors that practice within the state. This SAS is effective for audits of financial statements for periods ending on or after December 15, 2006.

## Dating the Auditor's Reports

**.115** SAS No. 103 also includes amendments to SAS No. 1, section 530, *Dating of the Independent Auditor's Report* (AICPA, *Professional Standards*, vol. 1, AU sec. 530.01 and .05). The amendment requires that your report not be dated earlier than the date on which you have obtained sufficient competent audit evidence to support the opinion on the financial statements.

**.116** The AICPA has issued Practice Alert No. 07-1, *Dating of the Auditor's Report and Related Practical Guidance*, providing information that may help practitioners interpret this requirement. See the discussion in the next section of this alert.

**.117** The auditor's report on compliance and on internal control over compliance related to major programs, as required by Circular A-133, ordinarily should have the same date as that of the other reports, but may carry a later date because some of the audit work to satisfy Circular A-133 requirements may be done subsequent to the work on the financial statements. When this is the case, the reporting required by Circular A-133 should be dated at the later date (that is, when the auditor has obtained sufficient appropriate audit evidence to support the report on the audit of compliance).

## Audit Documentation Technical Practice Aids

**.118** In May 2007, the ASB issued two practice aids related to SAS No. 103, which was issued in December 2005.

**.119** Technical Questions and Answers (TIS) section 9100.06, "The Effect of Obtaining the Management Representation Letter on Dating the Auditor's Report" (AICPA, *Technical Practice Aids*) discusses whether the auditor is required to have the signed management representation letter in hand as of the

date of the auditor's report. This question and answer indicates that although the auditor need not be in physical receipt of the representation letter on the date of the auditor's report, management will need to have reviewed the final representation letter and, at a minimum, have orally confirmed that they will sign the representation letter, without exception, on or before the date of the representations. The auditor will need to have the signed management representation letter in hand prior to releasing the auditor's report because, since management's refusal to furnish written representations constitutes a limitation on the scope of the audit sufficient to preclude an unqualified opinion.

**.120** TIS section 8350.01, "Current Year Audit Documentation Contained in the Permanent File" (AICPA, *Technical Practice Aids*), discusses whether the provisions of SAS No. 103 related to documentation completion and retention apply to current year audit documentation maintained in the permanent file. This question and answer indicates that SAS No. 103 does apply to current year audit documentation maintained in a permanent file, or for that matter, maintained in any type of file, if the documentation serves as support for the current year's audit report.

### **Practice Alert No. 07-1, *Dating of the Auditor's Report and Related Practical Guidance***

**.121** A key provision of SAS No. 103 is the amendment to paragraphs .01 and .05 of AU section 530, *Dating of the Independent Auditor's Report* (AICPA, *Professional Standards*, vol. 1), to require that the auditor's report not be dated earlier than the date on which the auditor has obtained sufficient appropriate audit evidence to support the opinion on the financial statements. As defined in the footnote to paragraph .01 of AU section 530, sufficient appropriate audit evidence includes, among other things, evidence that the audit documentation has been reviewed and that the entity's financial statements, including disclosures, have been prepared and that management has asserted that they have taken responsibility for them. Application of the rules may require revising the process used by audit firms at the end of fieldwork to include a field review of the audit working papers and financial statements. For some firms an additional visit to the client's office to update subsequent event analysis and management's representations may be required as well.

**.122** The Professional Issues Task Force (PITF) issued Practice Alert No. 07-1 to provide guidance to auditors of nonissuers regarding the following:

- The audit report date
- Evidence supporting financial statement amounts and disclosures—specifically relating to attorney letters, obtaining waivers, and consideration and evaluation of subsequent events
- Financial statement preparation and management's assertions
- Evidence that the audit documentation has been reviewed

**.123** Readers may access the practice alert at [www.aicpa.org/download/auditstd/pract\\_alert/pa\\_2007\\_1.pdf](http://www.aicpa.org/download/auditstd/pract_alert/pa_2007_1.pdf). Readers should also note the PITF is currently working on a practice alert that addresses auditing and other considerations related to electronic information which it plans to issue during the third quarter of 2007.

## AICPA Peer Review Checklists—A Tool to Help Improve Audit Quality

**.124** In performing peer reviews, review teams must complete all relevant programs and checklists issued by the AICPA Peer Review Board. The AICPA updates its *Peer Review Checklists* annually; the 2007 versions of those checklists (which include checklists on state and local government, health care, and not-for-profit audits; GAS audits; single audits; and HUD audits) are now available. While intended for use in peer reviews, the various relevant checklists may be a helpful tool for your firm or audit organization to use as a memory jogger to ensure you have not overlooked anything significant before issuing your audit reports. Taking this step may help you improve your audit quality. The various relevant checklists can be accessed through the GAQC at [gaqc.aicpa.org/Resources/Research+Tools+and+Aids/Peer+Review+Checklists.htm](http://gaqc.aicpa.org/Resources/Research+Tools+and+Aids/Peer+Review+Checklists.htm).

## Recent AICPA Independence and Ethics Pronouncements

**.125** The AICPA *Independence and Ethics Alert—2007/08* (product no. 022478kk) contains a complete update on new independence and ethics pronouncements. This alert can be obtained by calling the AICPA at (888) 777-7077 or going online at [www.cpa2biz.com](http://www.cpa2biz.com). Readers should obtain this alert to be aware of independence and ethics matters that will affect their practice.

## Independence Requirements Under AICPA Rules, GAS, and Circular A-133

**.126** If you perform audits under GAS (including Circular A-133 audits), then you should be aware of the independence rules in those standards and regulations, as well as the independence rules of the AICPA. The AICPA's Professional Ethics Executive Committee (PEEC) proposes and issues ethics interpretations and rulings relating to independence and other ethics matters. You can download recent proposals and rulings from the AICPA Web site at [www.aicpa.org/Professional+Resources/Professional+Ethics+Code+of+Professional+Conduct/Professional+Ethics/](http://www.aicpa.org/Professional+Resources/Professional+Ethics+Code+of+Professional+Conduct/Professional+Ethics/).

**.127** In a GAAS audit, AICPA members are required to comply with the AICPA's Code of Professional Conduct Rule 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 101.01). Ethics Interpretation 101-3, "Performance of Nonattest Services" (AICPA, *Professional Standards*, vol. 2, ET sec. 101.05), establishes requirements that members should meet to perform nonattest services for an attest client without impairing independence with regard to that client.

**Help Desk**—In July 2006, the AICPA published a Practice Aid, *Independence Compliance: Checklists and Tools for Complying With AICPA and GAO Independence Requirements* (product no. 006627kk). This valuable tool contains a series of checklists to help auditors determine their compliance with applicable independence rules. The publication can be obtained at [www.cpa2biz.com](http://www.cpa2biz.com) or by calling the AICPA at (888) 777-7077.

**.128** For audits conducted in accordance with GAS, auditors and audit organizations also are subject to the GAS independence rules. Those rules, which are, in some cases, very similar to the AICPA independence rules and in other cases more restrictive, address when auditors and their organizations are independent from the organizations they audit by defining when personal, external, and organizational impairments to independence exist.

**.129** To comply with the GAS provisions governing nonaudit services to audit clients, audit organizations are required to meet two overarching principles. First, audit organizations are barred from performing management functions or making management decisions for their clients. Second, audit organizations are prohibited from auditing their own work or providing nonaudit services if the services are material or significant to the subject matter of the audit. Paragraphs 3.24–.30 of GAS discuss various types of nonaudit services and the affect that they have on auditor independence. The GAO has issued a question and answer document, *Answers to Independence Standard Questions*, to address its independence standard.

**Help Desk**—*Answers to Independence Standard Questions* is available on the Web at [www.gao.gov/govaud/ybk01.htm](http://www.gao.gov/govaud/ybk01.htm). The AICPA Web site provides a useful discussion of the AICPA and GAO independence rules at [www.aicpa.org/audcommctr/spotlight/Govt\\_21\\_Independence\\_and\\_Related\\_Topics.htm](http://www.aicpa.org/audcommctr/spotlight/Govt_21_Independence_and_Related_Topics.htm).

**.130** Finally, you should note that Section 305(b) of Circular A-133 contains an additional independence requirement. Under Circular A-133, an auditor who prepares the indirect cost proposal or cost allocation plan may not also perform the single audit when indirect costs recovered by the auditee during the prior year, as defined, exceeded \$1 million.

## On the Horizon

**.131** Auditors should keep abreast of auditing and accounting developments and upcoming guidance that may affect their engagements. Presented in the following sections is brief information about some ongoing projects that have particular significance to *Government Auditing Standards* or Circular A-133 audits or that may result in significant changes. Remember that exposure drafts are nonauthoritative and cannot be used as a basis for changing existing standards.

**.132** The following table lists the various standard-setting bodies' Web sites, where information may be obtained on outstanding exposure drafts, including downloading exposure drafts. These Web sites contain much more in-depth information about proposed standards and other projects in the pipeline. Many more accounting and auditing projects exist in addition to those discussed here. Readers should refer to information provided by the various standard-setting bodies for further information.

<i>Standard-Setting Body</i>	<i>Web Site</i>
AICPA Auditing Standards Board (ASB)	<a href="http://www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/Auditing+Standards+Board/">www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/Auditing+Standards+Board/</a>
AICPA Accounting Standards Executive Committee (AcSEC)	<a href="http://www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Accounting+Standards/">www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Accounting+Standards/</a>
Financial Accounting Standards Board (FASB)	<a href="http://www.fasb.org">www.fasb.org</a>
Public Company Accounting Oversight Board (PCAOB)	<a href="http://www.pcaob.org">www.pcaob.org</a>
Professional Ethics Executive Committee (PEEC)	<a href="http://www.aicpa.org/Professional+Resources/Professional+Ethics+Code+of+Professional+Conduct/Professional+Ethics/">www.aicpa.org/Professional+Resources/Professional+Ethics+Code+of+Professional+Conduct/Professional+Ethics/</a>
Securities and Exchange Commission (SEC)	<a href="http://www.sec.gov">www.sec.gov</a>

**Help Desk**—The AICPA's standard-setting committees publish exposure drafts of proposed professional standards exclusively on the AICPA Web site. The AICPA will notify interested parties by e-mail about new exposure drafts. To be added to the notification list for all AICPA exposure drafts, send your e-mail address to [service@aicpa.org](mailto:service@aicpa.org). Indicate "exposure draft e-mail list" in the subject header field to help process your submission more efficiently. Include your full name, mailing address, and, if known, your membership and subscriber number in the message. The AICPA Web site also has connecting links to the other standard-setting bodies listed here.

Auditing Pipeline

ASB Clarity Project

**.133** The ASB has formed a Clarity Task Force to address concerns over the clarity, length, and complexity of generally accepted auditing standards. In March 2007, the ASB approved for exposure a discussion paper, *Improving the Clarity of ASB Standards*. This discussion paper seeks feedback on proposed changes to the standards, including the following:

- Establishing objectives for each of the standards and the auditor's obligations related to the objectives
- Structural and drafting improvements to make the standards easier to read and understand

- Inclusion, in the explanatory material of the standards, of special considerations related to audits of public entities and small entities
- Establishing a glossary of terms that would be presented in a separate section of the codification of the standards

**.134** The period to comment ended June 15, 2007. The discussion paper can be accessed at [www.aicpa.org/download/auditstd/Clarity\\_of\\_ASB\\_Standards\\_Discussion\\_Memo.pdf](http://www.aicpa.org/download/auditstd/Clarity_of_ASB_Standards_Discussion_Memo.pdf).

### **Convergence With International Standards**

**.135** The ASB has created a number of task forces charged with monitoring specific activities of the IAASB and working toward convergence with international auditing standards. The ASB has commented on several exposure drafts of International Standards on Auditing (ISA). The status of these and other ASB projects can be monitored online at [www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/Auditing+Standards+Board/](http://www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/Auditing+Standards+Board/).

### **Response to Single Audit Quality Issues**

**.136** With the increased focus on single audit quality (see "Results of Federal Study on Single Audit Quality" in this alert), there are likely to be many new projects taken on over the course of the next year and into the future to address the audit deficiencies cited in the PCIE report. These projects could result in revisions to AU section 801, *Compliance Auditing Considerations in Audits of Governmental Entities and Recipients of Governmental Financial Assistance* (AICPA, *Professional Standards*, vol. 1), the GAS/A-133 Guide, and other standards, regulations, and guidance. The best way to keep informed of developments over the next year is to watch the GAQC Web site at [www.aicpa.org/GAQC](http://www.aicpa.org/GAQC) for updates and news items.

### **Resource Central**

**.137** The following are various resources that practitioners engaged in *Government Auditing Standards* and Circular A-133 audits may find beneficial.

### **Publications**

**.138** Practitioners may find the following publications useful with respect to *Government Auditing Standards* and Circular A-133 audits.

- Audit Guide *Government Auditing Standards and Circular A-133 Audits* (2007) (product no. 012747kk)
- Audit and Accounting Guide *State and Local Governments* (2007) (product no. 012667kk)
- Audit and Accounting Guide *Not-for-Profit Organizations* (2007) (product no. 012647kk)
- Audit and Accounting Guide *Health Care Organizations* (2007/08) (product no. 012617kk)
- Audit Guide *Analytical Procedures* (2007) (product no. 012557kk)
- Audit Guide *Assessing and Responding to Audit Risk in a Financial Statement Audit* (2006) (product no. 012456kk)

- Audit Guide *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities* (2007) (product no. 012527kk)
- Audit Guide *Audit Sampling* (2007) (product no. 012537kk)
- Audit Guide *Service Organizations: Applying SAS No. 70, as Amended* (2007) (product no. 012777kk)
- AICPA *Audit Risk Alert—2007/08* (product no. 022338kk)
- *Compilation and Review Alert—2007/08* (product no. 022308kk)
- Audit Risk Alert *Independence and Ethics—2007/08* (product no. 022478kk)
- Audit Risk Alert *Understanding the New Auditing Standards Related to Risk Assessment* (product no. 022526kk)
- Audit Risk Alert *Understanding SAS No. 112 and Evaluating Control Deficiencies* (product no. 022536kk)
- *Checklist and Illustrative Financial Statements for State and Local Governments* (product no. 009037kk)
- *Checklist and Illustrative Financial Statements for Not-For-Profit Organizations* (product no. 008987kk)
- *Independence Compliance: Checklists and Tools for Complying With AICPA and GAO Independence Requirements* (product no. 006627kk)
- *Accounting Trends and Techniques—Not-For-Profit Organizations* (product no. 006616kk)
- *Audit and Accounting Manual* (2007) (product no. 005137kk)

## AICPA reSOURCE: Accounting and Auditing Literature

**.139** The AICPA has created your core accounting and auditing library online. AICPA reSOURCE is now customizable to suit your preferences or your firm's needs. Or, if you prefer to have access to the entire library, that is available too. Get access—anytime, anywhere—to the AICPA's latest *Professional Standards*, *Technical Practice Aids*, *Audit and Accounting Guides* (more than 20), *Audit Risk Alerts* (more than 15), and *Accounting Trends & Techniques*. To subscribe to this essential online service for accounting professionals, go to [www.cpa2biz.com](http://www.cpa2biz.com).

## Continuing Professional Education

**.140** The AICPA offers a number of CPE courses that are valuable to CPAs working in public practice and industry. Among the many courses, the following may be of specific interest to auditors of organizations subject to *Government Auditing Standards* and Circular A-133 audits.

- *State & Local Government Strategic Briefing—2006/2007*
- *Foundations in Governmental Accounting*
- *Governmental Accounting and Auditing Update—2006/2007 Edition*
- *Workpaper Techniques for Government and Nonprofit Organizations*
- *Government Accounting and Reporting: Putting It All Together*
- *Audits of HUD-Assisted Projects*



.141 Visit [www.cpa2biz.com](http://www.cpa2biz.com) for a complete list of CPE courses.

### **Online CPE**

.142 AICPA CPEExpress (formerly AICPA InfoBytes), offered exclusively through CPA2Biz.com, is AICPA's flagship online learning product. AICPA CPEExpress now offers a free trial subscription to the entire product for up to 30 days. AICPA members pay \$149 for a new subscription and \$119 for the annual renewal. Nonmembers pay \$369 for both. Divided into 1 and 2 credit courses that are available 24 hours a day, 7 days a week, AICPA CPEExpress offers hundreds of hours of learning in a wide variety of topics. Some topics of special interest to auditors of organizations subject to *Government Auditing Standards* and Circular A-133 audits include the following:

- *Yellow Book: An Overview*
- *2007 Annual Update-Government: GASB Activities*
- *Governmental and NPO Workpaper Preparation Techniques Overall Approach*
- *Fraud in Exempt Organizations: The Governmental and Not-for-Profit Environments*

.143 To register or learn more, visit [www.cpa2biz.com](http://www.cpa2biz.com).

### **Webcasts**

.144 Stay plugged in to what is happening and earn CPE credit right from your desktop. AICPA webcasts are high-quality, two-hour CPE programs that bring you the latest topics from the profession's leading experts. Broadcast live, they allow you to interact with the presenters and join in the discussion. If you cannot make the live event, each webcast is archived and available on CD-ROM.

### **Member Service Center**

.145 To order AICPA products, receive information about AICPA activities, and find help on your membership questions, call the AICPA Service Operations Center at (888) 777-7077.

### **Hotlines**

#### ***Accounting and Auditing Technical Hotline***

.146 Do you have a complex technical question about GAAP, other comprehensive bases of accounting, or other technical matters? If so, use the AICPA's Accounting and Auditing Technical Hotline. AICPA staff will research your question and call you back with the answer. You can reach the Technical Hotline at (888) 777-7077.

#### ***Ethics Hotline***

.147 In addition to the Technical Hotline, the AICPA also offers an Ethics Hotline. Members of the AICPA's Professional Ethics Team answer inquiries concerning independence and other behavioral issues related to the application of the AICPA Code of Professional Conduct. You can reach the Ethics Hotline at (888) 777-7077.



## Industry Conference

**.148** The AICPA sponsors four annual conferences that focus on GAS and Circular A-133 topics in the summer and fall of each year.

**.149** *Governmental Accounting and Auditing Update Conference (GAAC) EAST* is held in late summer in Washington, D.C., and its counterpart, *Governmental Accounting and Auditing Update Conference (GAAC) WEST*, takes place in Tempe, AZ in early fall. They are designed for CPAs working in federal, state, and local government; public practitioners with government clients; and regulators who need to be aware of emerging developments should attend this conference to remain current on the issues. Attending one of these conferences is a great way to receive timely guidance along with practical advice on how to handle new legislation and standards from key government officials and representatives of the accounting profession—including the standard setters themselves.

**.150** *AICPA National Governmental and Not-for-Profit Training* is held in Lake Buena Vista, FL. If you need hands on training and are a CPA in public practice—or a governmental or not-for-profit staffer—then this conference is for you. You'll hear directly from the standards setters and industry leaders on a variety of topics including developments in governmental accounting and auditing, the latest in proposed regulations and laws on the local, state, and federal government levels, as well as those affecting the not-for-profit sector and more.

**.151** *Not-for-Profit Industry Conference* is held in early summer in Washington, D.C. The conference offers a wide range of topics geared to NPO professionals at every level: tax, management, audit and accounting issues, fundraising, and regulatory issues.

**.152** For further information about the conferences, call (888) 777-7077 or visit [www.cpa2biz.com](http://www.cpa2biz.com).

## AICPA Governmental Audit Quality Center

**.153** The GAQC is a firm-based, voluntary membership center designed to improve the quality of governmental audits and the value of such audits to purchasers of governmental audit services. Governmental audits are audits and attestation engagements performed under *Government Auditing Standards* of federal, state, or local governments; not-for-profit organizations; and certain for-profit organizations, such as housing projects and colleges and universities that participate in governmental programs or receive governmental financial assistance. The GAQC keeps member firms informed about the latest developments, as well as provides tools and information to help them better manage their audit practice. Firms that join demonstrate their commitment to audit quality by agreeing to adhere to certain membership requirements.

**.154** The GAQC has been in existence since September 2004. Since its launch, center membership has grown to over 850 firms from 50 states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands. The membership accounts for approximately 82 percent of the total federal expenditures covered in single audits performed by CPA firms in the Federal Audit Clearinghouse database ([harvester.census.gov/sac/](http://harvester.census.gov/sac/)) for the year 2004 (the latest year with complete submission data).

**.155** The Center's focus is to promote the highest quality audits and to save firms time by providing a centralized place to find information they need, when they need it, to maximize quality and practice success. Center resources include the following:

- E-mail news alerts on current audit and regulatory developments that keep member firms informed about the latest developments
- Dedicated center Web site at [www.aicpa.org/GAQC](http://www.aicpa.org/GAQC) with Resources, Community, Events and Products, and a complete listing of GAQC members in each state
- Online Member Discussion Forums for sharing best practices and discussing issues firms are facing
- Webcasts, Web seminars, and teleconferences updating members on a variety of technical, legislative, regulatory, and practice management subjects (note that these activities are archived on the GAQC Web site)

**Help Desk**—With all of the quality issues being noted in governmental audits, as discussed in this alert, your firm should consider joining the center. To enroll or learn more about the GAQC, including details on the membership requirements and fees for membership, go to [www.aicpa.org/GAQC](http://www.aicpa.org/GAQC) or e-mail GAQC staff at [GAQC@aicpa.org](mailto:GAQC@aicpa.org). To preview member benefits, go to [gaqc.aicpa.org/Memberships/](http://gaqc.aicpa.org/Memberships/).

## AICPA State and Local Government Expert Panel

**.156** The State and Local Government Expert Panel is an AICPA volunteer group whose purpose it is to identify state and local government financial reporting and auditing issues and to work with appropriate bodies for resolutions benefiting the public interest; to conduct liaison activities with the GASB, regulators such as the GAO and the OMB, and applicable industry associations; and to advise and assist in the development of AICPA products and services related to state and local government audits. For information about the activities of the State and Local Government Expert Panel, visit the AICPA Web site at [www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Accounting+Standards/expertpanel\\_government.htm](http://www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Accounting+Standards/expertpanel_government.htm).

## AICPA Not-For-Profit Organization Expert Panel

**.157** The Not-For-Profit Organization Expert Panel is an AICPA volunteer group whose purpose it is to identify financial reporting and auditing issues unique to not-for-profit organizations and to work with appropriate bodies for resolutions benefiting the public interest; to conduct liaison activities with the AICPA Accounting Standards Executive Committee (AcSEC) and Financial Accounting Standards Board (FASB); and to advise and assist in the development of AICPA products and services related to not-for-profit organizations. For information about the activities of the Not-For-Profit Organization Expert Panel, visit the AICPA Web site at [www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Accounting+Standards/expertpanel\\_notforprofit.htm](http://www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Accounting+Standards/expertpanel_notforprofit.htm).

## Industry Web Sites

**.158** The Internet covers a vast amount of information that may be valuable to auditors of organizations that are subject to *Government Auditing Standards* or OMB Circular A-133 Audits, including current industry trends and developments. Some of the more relevant sites are shown in the appendix of this alert. The governmental or not-for-profit audit practice sections of some of the larger CPA firms may also contain specific auditing and accounting information that is helpful to auditors.

**.159** This Audit Risk Alert replaces *Government Auditing Standards and Circular A-133 Audits—2006*.

**.160** The Audit Risk Alert *Government Auditing Standards and Circular A-133 Audits* is published annually. As you encounter audit or industry issues that you believe warrant discussion in next year's Audit Risk Alert, please feel free to share them with us. Any other comments that you have about the Audit Risk Alert would also be appreciated. You may e-mail these comments to [sreed@aicpa.org](mailto:sreed@aicpa.org) or write to:

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## Appendix—Additional Web Resources

Here are some useful Web sites that may provide valuable information to auditors and accountants.

<b>Web Site Name</b>	<b>Content</b>	<b>Web Site</b>
American Institute of CPAs (AICPA)	Summaries of recent auditing and other professional standards as well as other AICPA activities	<a href="http://www.aicpa.org">www.aicpa.org</a> <a href="http://www.cpa2biz.com">www.cpa2biz.com</a>
AICPA Accounting Standards Executive Committee (AcSEC)	Issues SOPs, guides, Practice Bulletins containing financial, accounting, and reporting recommendations, among other things	<a href="http://www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Accounting+Standards">www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Accounting+Standards</a>
AICPA Accounting and Review Services Committee (ARSC)	Develops and issues review and compilation standards and interpretations	<a href="http://www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/Accounting+and+Review+Services+Committee">www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/Accounting+and+Review+Services+Committee</a>
AICPA Professional Issues Task Force (PITF)	Accumulates and considers practice issues that appear to present concerns for practitioners and for disseminating information or guidance, as appropriate, in the form of practice alerts	<a href="http://www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/Professional+Issues+Task+Force">www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/Professional+Issues+Task+Force</a>
AICPA Governmental Audit Quality Center (GAQC)	Information and updates on the latest information relating to governmental auditing, particularly for audits performed under <i>Government Auditing Standards</i> and OMB Circular A-133	<a href="http://www.aicpa.org/GAQC">www.aicpa.org/GAQC</a>

(continued)

<b>Web Site Name</b>	<b>Content</b>	<b>Web Site</b>
Economy.com	Source for analysis, data, forecasts, and information on the United States and world economies	<a href="http://www.economy.com">www.economy.com</a>
The Federal Reserve Board	Key interest rates	<a href="http://www.federalreserve.gov">www.federalreserve.gov</a>
Financial Accounting Standards Board (FASB)	Summaries of recent accounting pronouncements and other FASB activities	<a href="http://www.fasb.org">www.fasb.org</a>
USA.gov	Portal through which all government agencies can be accessed	<a href="http://www.usa.gov">www.usa.gov</a>
Government Accountability Office (GAO)	Policy and guidance materials, reports on federal agency major rules	<a href="http://www.gao.gov">www.gao.gov</a>
Governmental Accounting Standards Board (GASB)	Summaries of recent accounting pronouncements and other GASB activities	<a href="http://www.gasb.org">www.gasb.org</a>
General Printing Office Access	Provides links to search the Code of Federal Regulations, Federal Register, and Public Laws	<a href="http://www.access.gpo.gov">www.access.gpo.gov</a>
International Accounting Standards Board (IASB)	Summaries of International Financial Reporting Standards and International Accounting Standards	<a href="http://www.iasb.org">www.iasb.org</a>
International Federation of Accountants (IFAC)	Information on standards-setting activities in the international arena	<a href="http://www.ifac.org">www.ifac.org</a>
Public Company Accounting Oversight Board (PCAOB)	Information on accounting and auditing the activities of the PCAOB and other matters	<a href="http://www.pcaob.org">www.pcaob.org</a>
Securities and Exchange Commission (SEC)	Information on current SEC rulemaking and the EDGAR database	<a href="http://www.sec.gov">www.sec.gov</a>